FHA REVITALIZATION ACT OF 1981

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

FIRST SESSION

ON

S. 1702

TO AMEND THE NATIONAL HOUSING ACT TO PROVIDE ADDITIONAL MORTGAGE AND LOAN INSURANCE AUTHORITY

NOVEMBER 19, 1981

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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FHA REVITALIZATON ACT OF 1981

THURSDAY, NOVEMBER 19, 1981

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS,

Washington, D.C.

The subcommittee met at 9:30 a.m. in room 5302, Dirksen Senate Office Building, Senator Richard G. Lugar (chairman of the subcommittee) presiding.

OPENING STATEMENT OF SENATOR LUGAR

Senator LUGAR. This meeting of the Housing Subcommittee is now called to order.

Today we will consider the future of FHA and the role it should play in the housing market.

We will consider a variety of proposed changes to the existing FHA law and consider the effect those changes will have on FHA, on homebuyers, and on the housing market.

That we are considering changes to FHA at this time is particularly appropriate. We are suffering the worst housing market we have experienced since FHA was first authorized. Today we face a market with new starts and resales at a level comparable to the conditions of the depression.

In 1934 when FHA was authorized, new construction had virtually stopped. New home construction amounted to 10 percent of the peak construction year of 1925; 50 percent of the mortgages in the Nation were in default and the foreclosure rate peaked at 1,000 homes per day. Moreover the prospects for improvement without an FHA were dim.

At that time families typically financed homes with mortgages that required a 35- to 50-percent downpayment, had a term of less than 10 years and, even if one could afford those terms, mortgage money was scarce.

FHA was authorized to pioneer new concepts in home finance and expand homeownership in America. It established the security and the marketability of: mortgage insurance, long-term, fixed-rate mortgages, standardized contracts and appraisals, low downpayment mortgages, mobile home lending, and more recently graduated payment mortgages. Because of FHA and a series of other housing finance improvements, the United States is overwhelmingly a nation of homeowners.

However, we find that tradition of homeownership threatened by a revolution in the financial markets and soaring inflation. Homeownership is fast disappearing as an option for all but a few of those who do not already own a home. The combination of high

prices and high interest mortgages have priced homes out of the reach of most Americans.

Homeownership is an important part of this country. It provides stability and pride unknown in other parts of the world.

It is critical that homeownership remains available to young families and that most Americans can continue to own a home.

FHA can play a role in providing continued homeownership opportunities. Today we consider that role and how FHA will respond to the challenges of the future.

I have introduced legislation, S. 1702, which suggests a wide range of changes. It would dramatically expand the ability of FHA to cope with today's housing economy.

It is controversial legislation. It provides full authority to try concepts far more risky than FHA's current programs.

I introduced this legislation and scheduled this hearing because I believe we must consider all the alternatives. I do not believe that every part of this legislation is critical to the future of FHA. But the legislation does raise important questions about the future role of FHA, namely: Should FHA be free to experiment outside of specific congressional authority; should FHA offer insurance on alternative mortgage instruments; should FHA encourage forms of ownership other than traditional fee simple ownership; are the minimum property standards an obstacle to affordable housing; why doesn't FHA insure more inner city housing?

We have assembled a group of witnesses well qualified to provide guidance on the subject, witnesses qualified to comment on all these questions and to offer suggestions for FHA's future and the future of homeownership in America.

Let me review very briefly a summary of S. 1702, the legislation that we are considering today, the FHA Revitalization Act of 1981.

The legislation is based on the premise that FHA needs the authority to find ways to reduce the cost of financing and reduce housing prices through increased productivity and reduce prices by removing some of the components of housing costs.

The legislation is a combination of virtually all the suggestions the committee has received on ways to help FHA cope with current and future conditions.

Since introducing the bill we have found that it needs a number of technical improvements; nonetheless, the basic principles are sound.

Title I gives FHA general mortgage insurance experimental authority. Under this title FHA could probably do almost anything it chose to do.

Title II authorizes FHA to insure 5-year Canadian rollover mortgages. This title is probably unneeded because title I is so broad, but this particular form of financing seems to offer the most advantages. The title also gives GNMA authority to guarantee 5-year rollover mortgages.

Title III, as we look at it, authorizes FHA to insure condominium projects and establishes other methods of determining values for projects, allows FHA insurance for investors who buy condominium units and eliminates Davis-Bacon requirements for condominium projects. Under current law, section 234, the title may be unusable because the law requires that the units be built for a year and that

a number of units be built before FHA can insure them. It gives FHA expanded authority to insure homes on leased land. FHA currently has authority to insure mortgages for homes on leased land if the landlease is 50 years or longer.

Title V gives FHA authority to insure manufactured home mortgages if the home is on a permanent foundation. This provision parallels in many ways the program FNMA already offers. This will bring manufactured homes into full equality with site-built homes.

Title VI gives FHA authority to waive the minimum property standards on homes older than 30 years. This provision is an attempt to overcome one of the obstacles to FHA activity in core cities. At the present time, FHA has only 1.7 percent of its mortgages in core cities.

These comments in summary reflect what S. 1702 attempts to do, likewise some comments which have been made by experts on this prior to the hearing, and I offer it simply as a summary for the benefit of witnesses and the press and to those who are with us today so all will have some idea of where we're heading.

[Copy of S. 1702 follows:]

II

97TH CONGRESS
1ST SESSION

S. 1702

To amend the National Housing Act to provide additional mortgage and loan insurance authority.

IN THE SENATE OF THE UNITED STATES

OCTOBER 5 (legislative day, SEPTEMBER 9), 1981

Mr. LUGAR introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the National Housing Act to provide additional mortgage and loan insurance authority.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "FHA Revitalization Act of 1981".

TITLE I—GENERAL AUTHORITY

SEC. 101. Title II of the National Housing Act is amended by adding at the end thereof the following:

"EXPERIMENTAL INSURANCE AUTHORITY

"SEC. 247. (a) The Secretary may insure under any provision of this title a mortgage or loan which has an adjustable interest rate, which may be required to be refinanced prior to the end of amortization, which involves the payment of discount points by the buyer or seller for the purpose of reducing the nominal interest rate, or which contains other provisions which make the mortgage ineligible for insurance under this title.

"(b) Notwithstanding any other provision of this title—

"(1) the principal obligation of a mortgage or loan insured pursuant to this section may not exceed such percentage of the appraised value of the property covered by the mortgage or loan as of the date the mortgage or loan is accepted for insurance as the Secretary may prescribe; and

"(2) the mortgage or loan shall be subject to such other terms and conditions as the Secretary may prescribe.

"(c) The Secretary may not provide insurance under this section with respect to a mortgage or loan executed by a mortgagor or borrower who, as determined by the Secretary, has owned a dwelling unit within the three years preceding the date of the application for insurance.

"(d) Section 245(c) shall apply to a mortgage or loan insured pursuant to this section which contains graduated mortgage provisions if such provisions meet the requirements of section 245.".

SEC. 102. Section 203(b)(2) of such Act is amended by striking out "$76,000", "$92,000", and "$107,000" and inserting in lieu thereof "$120,000", "$180,000", and "$240,000", respectively.

TITLE II—FIVE-YEAR MORTGAGES

SEC. 201. Section 203 of the National Housing Act is amended by adding the following new subsection at the end thereof:

"(q)(1) The Secretary is authorized to insure under this section any mortgage meeting the requirements of subsection (b) of this section, except as modified by this subsection.

"(2) To be eligible for insurance under this subsection, a mortgage shall—

"(A) have a maturity satisfactory to the Secretary, but not to exceed, in any event, five years from the date of execution of the mortgage;

"(B) not provide for complete amortization as of maturity; and

"(C) bear interest at the constant rate applicable to mortgages insured under this section.

"(3) A mortgage insured under this subsection may be refinanced, and the mortgage executed to refinance such earlier mortgage may be insured in accordance with this subsection or subsection (b) if such later mortgage is eligible for insurance under either subsection.".

SEC. 202. Section 302(b)(1) of the National Housing Act is amended by inserting "or section 203(q)" after "203(k)" in clause (3) of the proviso.

TITLE III—CONDOMINIUMS

SEC. 301. Section 234(c) of the National Housing Act is amended by striking out clause (2) and by redesignating clause (3) as clause (2).

SEC. 302. Section 234(e) of the National Housing Act is amended by adding at the end thereof the following: "Notwithstanding the preceding sentence, the principal obligation of a blanket mortgage on a newly constructed multifamily project may be an amount not to exceed, for such part of the project as may be attributable to dwelling use (excluding exterior land improvements as defined by the Secretary), 70 per centum of the appraised value of the property, including the value of units rented by the developer for not to exceed five years and units owned by investors, as of the date construction is completed.".

SEC. 303. Section 212(a) of the National Housing Act is amended by striking out the fifth sentence.

TITLE IV—MORTGAGE INSURANCE FOR HOMES ON LEASED LAND

SEC. 401. Section 203 of the National Housing Act is amended by adding the following new subsection at the end thereof:

"(r) The Secretary shall exercise the authority conferred by this section with respect to dwelling units on leased land where the owner of the dwelling unit has, or will during the period of the lease have, an option to purchase the land.".

TITLE V—MORTGAGE INSURANCE ON CERTAIN HOMES

SEC. 501. Section 203 of the National Housing Act is amended by adding the following new subsection at the end thereof:

"(s)(1) The Secretary is authorized to insure under this section any mortgage meeting the requirements of subsection (b) of this section, except as modified by this subsection.

"(2) To be eligible for insurance under this subsection, a mortgage shall—

"(A) involve a principal obligation (including such initial service charges, appraisal, inspection, and other fees as the Secretary shall approve) in an amount which does not exceed 97 per centum of the appraised value of the property;

"(B) have a maturity satisfactory to the Secretary, but not to exceed, in any event, thirty years from the date of the beginning of amortization of the mortgage;

"(C) be secured by a dwelling which satisfies standards prescribed under the National Manufactured Housing Construction and Safety Standards Act of 1974; and

"(D) be secured by a dwelling which is affixed to a site-built permanent foundation.".

TITLE VI—PROPERTY STANDARDS

SEC. 601. Section 203(k) of the National Housing Act is amended—

(1) by inserting "acquisition for the purpose of rehabilitation or the" after "(i) the" in paragraph (2)(A)(i); and

(2) by adding at the end thereof the following:

"(6) A loan may be insured under this section to acquire a property which was constructed thirty or more years prior to the execution of the loan if the property complies with applicable local health and safety codes. Any such loan may be refinanced by the borrower and insured under this subsection during the five-year period following the acquisition if the maximum principal amount of the loan to refinance does not exceed 97 per centum of the appraised value of the prop-

erty as of the date of the refinancing and if the property complies with applicable local health and safety codes as of the date of refinancing.".

Senator LUGAR. Our first witness is Hon. Philip D. Winn, Assistant Secretary for Housing-Federal Housing Commissioner, Department of Housing and Urban Development.

We are very grateful that Secretary Winn has joined us this morning. I would say in preface to his testimony that the administration has not taken a comprehensive viewpoint on FHA at this time but he will be responsive to questions. We are grateful for his presence so we may have the benefit of his answers as part of our hearing record.

Secretary Winn, we welcome you this morning.

STATEMENT OF PHILIP D. WINN, ASSISTANT SECRETARY FOR HOUSING, FEDERAL HOUSING COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. WINN. Thank you, Senator. I want to thank you for giving me the opportunity to appear before you this morning. You are to be commended for your interest in our FHA program.

As is well known, the administration is currently reviewing the future role of FHA and it would be premature to comment on the specifics of your proposed FHA Revitalization Act of 1981 at this time.

However, I personally want to say that the fact that Congress is involved in this endeavor is most welcome.

Rather than taking the time this morning and your time to discuss the historical role of FHA, I believe it would be more constructive and useful to respond to any questions that you may have, but before I answer any queries, Senator, in a letter of November 3, you requested we discuss a number of technical issues. Those questions will be answered in a separate submission to the committee.

Senator LUGAR. Thank you very much, Secretary Winn.

In your opinion, what role should FHA play in the coming years?

FUTURE ROLE

Mr. WINN. That's a difficult question to answer and I'll try not to be too verbose. I have always had the philosophy that government should not play a role if the private sector can handle it. However, there are certain segments of our society that cannot be properly serviced by the private sector or the private insurance companies. I refer primarily to individuals living in the inner cities, the core

cities, and in addition to that, a vast number of younger people, first-time homebuyers, entry-level buyers, who need different types of mortgage instruments, who perhaps represent a greater credit risk, and who have not the ability to come up with the necessary downpayment which is required by the private insurers.

So I personally look for the future role of FHA to be redirected toward the entry-level buyer who cannot purchase through traditional methods and to those in the core and inner cities where funds are not available through private sources.

Senator LUGAR. Secretary Winn, how important, in your judgment, is it for FHA to be able to offer alternative mortgage instruments?

Mr. WINN. The whole financial structure in this country has changed dramatically, as we know, in the last few years, and if FHA is to satisfy the markets that I have just described, it cannot exist only by having 30-year fixed-rate mortgages.

We must have the flexibility because the financial markets are demanding this to insure mortgages other than the 30-year, fixed-rate mortgage.

Senator LUGAR. To what extent is FHA competing directly with private mortgage insurance companies?

Mr. WINN. There's no way to draw a line between competitive and noncompetitive operations of the two. I believe right now there is competition between FHA and the PMI's because we are both attracting the entry-level market. However, I think if we recognize where FHA should go—and that is in markets that are not satisfied by the private sector—then we could eliminate some of this competition through this redirection.

Senator LUGAR. If one wants to limit FHA's competition with private mortgage insurance, what is the best way to do that? For example, would restraining loan limits be the most effective means of limiting direct competition?

Mr. WINN. I don't think that's the way to do it. If we do not adjust loan limits based on inflation or decrease them based on deflation, then the mortgage instrument will fail to adequately reflect market conditions. To those who say we should never increase the limits, my only answer is if we had taken that attitude since 1934 then we would only have a $3,000 or $4,000 loan limit.

I think that we have to adjust the loan limit to reflect medium prices around the country. I think the way to eliminate competition, as I stated before, is not that method, but through a redirection of our programs primarily toward individuals who aren't purchasing at all today. I think there's a vast segment of the market that wants to purchase homes and should purchase homes and because of the lack of instruments on our part and because the private sector cannot handle them they are unable to purchase.

Senator LUGAR. Some have argued that FHA does not provide any significant service today that could not be accomplished by expanding the role of GNMA in the secondary market and providing coinsurance with private mortgage insurance companies. What are the functions that FHA performs and can they be accomplished through a secondary market program?

Mr. WINN. As we know, GNMA is the prime secondary market source for all FHA and VA loans. There has been discussion of the

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FHA taking part of the loan and the PMI taking the top 20 percent of the loan and processing this paper through the GNMA route.

After a lot of thought, I don't adhere to that policy. We have problems with credit in this country and, as we know, the GNMA's compete with Treasury because of the Federal guarantees. I would personally favor the continuation of GNMA only servicing FHA and VA paper, but at the same time redirecting FHA toward the markets that I described earlier.

MINIMUM PROPERTY STANDARDS OUTDATED

Senator LUGAR. To what extent do the minimum property standards make FHA homes cost more? The National Association of Home Builders, for example, feels that MPS adds 8 percent to the cost of FHA homes.

Mr. WINN. Over the years, by being overly protective to the consumer, what we have done through FHA has really hurt the individual we really try to help. It wasn't only the MPS, which I'll describe in a moment, but it was the myriad rules and regulations, with the net result that when a builder or developer wants to develop a piece of ground and get it insured by FHA he has to go through such a long ordeal and time delays that when the site is finally delivered the cost to the consumer has risen dramatically.

In addition to that, the whole minimum property standards are outdated. There are many rules and regulations in the MPS's that should be done away with. We at HUD—and I'm proud to say this—are taking a new look at not only the MPS's but the environmental impact statement, the overregulation there, the A-95 reviews and things of that nature.

Our goal is to reduce the regulations to the point where we can reduce dramatically the cost of housing. We are in the process of developing an affordability demonstration program around the country using 15 or 20 cities. We believe that just through overregulation not only on the part of the Federal Government through its FHA programs but primarily with municipalities and States, that if it were attacked properly, we could reduce the cost of housing by 20 percent. I know that's a dramatic figure, but we think that's correct.

I do agree that the MPS's themselves, if they were revised, probably take up about half that figure.

Senator LUGAR. That is a dramatic savings, 20 percent. Do you have some confidence that that is in the realm of the possible?

Mr. WINN. I would say this, Senator, that we at HUD will get our part done. The big job we will have to do is convincing the thousands of municipalities and State governments that they have a responsibility to house their people, and if we continue to just raise the cost of housing through overregulation, overprotective measures, we won't accomplish anything. But it can be done. And because we are facing a housing crisis in this country in the cities and States, through the new federalism they are going to have to realize their equal responsibility.

I do believe we have already accomplished a great deal in cutting regulations, and if we can continue what we are doing, we will get the job done, sir.

INNER CITIES PROBLEMS

Senator LUGAR. Let me zero in on the specific problems of the inner cities. Are the minimum property standards particularly troublesome for older homes in inner cities? If the MPS's are not a problem in the inner cities, why is only 1.8 percent of the FHA portfolio located in core cities and how can we expand the use of lower cost homes in FHA?

Mr. WINN. When I came here 8 months ago I looked at a very good program called 245(b) which is a low downpayment mortgage with a graduated payment provision added to it. This program was set up for people who could not afford the going rate and by having a graduated payment mortgage it allows people to qualify who otherwise could not. But interestingly enough, as good as this act was, for whatever reasons our predecessors had—and I have to presume the act was passed at that time to push new construction—it excluded used homes—the resale market—and condominiums.

So, if we look at the whole condominium aspect of FHA, in reality, we have no program because of the GPM exclusion. The few thousand units we have insured—I think it's something like 48,000 in the last 20-some-odd years—is nothing, and for the people that live in the core city, those are the two properties that they probably will go to—multifamily for sale and used properties—and actually, our programs excluded both.

This is the problem which we are attacking. Hopefully we can revise the 245(b) to include used properties. The problem we face is the financing mechanism more than it is the MPS's. We must, if we are sincere about developing homeownership in the core cities, develop a finance program which will be attractive to the investors and, of course, the purchasers. But without being too long in my answer to you, I don't think it's the MPS problem. I think it's purely the lack of capital or the lack of finance instruments that have caused practically no financing to speak of in the last few years in the core cities, both by the private sector and by FHA.

Senator LUGAR. The subcommittee has received a great deal of support for increased loan limits for two-, three-, and four- unit homes. Under current loan limits, is construction of these more efficient buildings feasible?

Mr. WINN. We are going into a new era in housing in this country. As we know, the mass amount of subsidized housing production in all probability, will be cut back, and we at HUD feel one of the ways to solve the housing dilemma is through smaller, multifamily rental and for sale production. We do have a program where we insure two-, three-, and four-family buildings, however the loan limits are so small—it's unworkable.

As an example, the maximum loan on a one-unit building I believe is $67,500 and on a two-unit building it's $76,000. Well, with today's cost at that limit you cannot build. We favor increasing those loan limits so we can have production in the two-, three-, and four-unit building where the owner can take care of his own property; in other words, live in one and rent two or three units out. But the loan limits that we presently have, Senator, just make the program unworkable.

Senator LUGAR. Congress has specified particular consumer protections in expanding FHA's authority.

Mr. WINN. I'm for consumer protection. But I think if you make our consumer protection program so restrictive by legislation that the programs cannot work because you can't live in a vacuum, I would prefer to see FHA and HUD have the flexibility to make the changes administratively as conditions change rather than have so many safeguards that the programs become unworkable.

Senator LUGAR. Although FHA does have authority to insure mortgages for leased-land homes, isn't it true that this authority is only used in a few locations and only where very long-term leases exist?

Mr. WINN. We have to be innovative and we do have an insurance program for homes on leased land. However, other than Hawaii and maybe one or two other States, it wasn't widely used.

On September 15, when we could do this administratively, we sent a bulletin out—I think it was September 15—to all of our field offices, basically loosening up our lease hold program. To tell you how much this will be used, I don't know, but it does obviously allow one to get in with a smaller downpayment and probably a lower monthly payment over the years. We did make this administrative change because we had the authority to do so.

Senator LUGAR. How much new money could be attracted to housing if GNMA developed a 5-year mortgage-backed security program?

Mr. WINN. Probably a lot of new money, both money coming from this country and from foreign nations. I might add, however, that while I'm in this chair I would not want to see a program developed where the payment was due in 5 years. I've met with many experts on Wall Street on this problem. What I would prefer to see is an instrument perhaps where the rate is adjusted every 5 years. I believe that the individuals that FHA should be servicing—the needy, the markets that aren't being handled by the PMI's, the youngsters—I couldn't be a party to a program where the loan was due and payable in 5 years.

But to answer your question directly, I presume that the paper would be attractive. Also I would be very fearful of the insurance fund if the loan was callable in 5 years. I don't think as long as I'm here that I could possibly support that.

I could support a program where the rate is adjusted periodically but, again, with the individuals that I think you should service—and I'm speaking only today for myself—I would be against any program where the rate is adjusted more often than 5 years. I think it's putting our client in a very precarious position.

FHA OBSTACLES IN CONDO INSURANCE

Senator LUGAR. What have been the obstacles to the FHA 234 program in condominium insurance over the last few years?

Mr. WINN. The 234 program is set up as a multifamily program with all of the constraints of multifamily production—Davis-Bacon, rules and regulations and the like. In order to insure a unit under 234(c), one of two things has to happen. The project has to have project approval, which means we have to go through the entire

regulations of multifamily which made it unworkable—and I can tell you this as an ex-builder, that I would never have gone through that grief.

We have made a breakthrough and just passed a regulation where we can piggyback, so to speak, VA CRB's, and this will open up the financing. I do believe if FHA is to have a future role in housing the young people in this country—and again, getting into markets that the private sector cannot get into—we have to be more responsive to the multifamily for sale market, which we have not been.

Senator LUGAR. Do you feel that first-time and marginal buyers should be the major focus of FHA and should that focus be an exclusive focus?

Mr. WINN. We have had many discussions at HUD, and I'll give you my personal opinion. It is not a position of this Department. I want to make that understood. Again, coming out of the private sector, I don't believe government should be in roles that the private sector can handle. I also do not believe that government should be using a finite amount of credit for all people in need of home financing; just a select few.

I favor—and I reiterate—I'm not taking the administration or my department position—a program where we direct our attention to the core cities where funds are not available, as I discussed earlier, and to the entry-level buyer. To me, that is the role that government should play. But I think to expand it any further is improper and to put it in proper perspective, if we have only a certain number of dollars to use for mortgage insurance, I think the role of government is to properly direct it.

As an example, today, I presume one could buy a $200,000 home and pay $125,000 down and get an FHA loan. That's not the purpose of government, and I'm personally against it.

Senator LUGAR. Secretary Winn, we deeply appreciate your coming this morning. We know from your initial comments that the administration has not taken a position on this bill obviously and on the future of FHA specifically, but you have been most forthcoming and helpful in your responses in the form of testimony that occurred in the question and answer session. It is most helpful to us.

Mr. WINN. Senator, since I have been here I have enjoyed working with you and I hope we continue. Thank you very much.

Senator LUGAR. Thank you for coming.

The Chair would like to call now Mr. David Kresge of the Joint Center for Urban Studies, Cambridge, Mass. Welcome, Mr. Kresge. You may proceed with your testimony.

STATEMENT OF DAVID T. KRESGE, JOINT CENTER FOR URBAN STUDIES, CAMBRIDGE, MASS.

Mr. KRESGE. Mr. Chairman, I'm delighted to be here with you today. I have submitted a more complete statement for the record and I will try to summarize the conclusions coming out of that report. In doing so, I would like to focus on three particular aspects. One is the role of young adults in the homeownership market. The second is the role of conversions and rehabilitation. And the third is the role of manufactured homes.

Any evaluation of housing policies such as those proposed in S. 1702 has to be set in the context of the potential housing needs over the coming years. On the basis of the work we've done at the Harvard-MIT Joint Center for Urban Studies, we anticipate that future housing markets will be characterized by the following conditions: Household formation will run about 1.3 to 1.4 new households per year through the mid-1980's, a rate only slightly lower than that experienced during the past decade. Household formation will fall off sharply by the late 1980's and early 1990's and by the year 2000 may be approaching only 800,000 units per year, which is even lower than the rate in 1960 and only about half the rate in recent experience.

Demand for rental units will fall off sharply due to the declining rate of household formation. By the end of the century, in fact, there will be almost no need to construct additional rental units. Demand for homeownership, in contrast, will at least potentially hold up through the 1980's and early 1990's. The demand will be sustained by the movement of the baby boom generation into the prime home buying ages. This assumes that severe affordability problems do not force potential buyers to change their plans.

HOUSING DEMANDS OF YOUNG ADULTS

Within this context, the housing demands of young adults are of particular relevance to the purpose of the proposed legislation. Young adults, those under the age of 35, account for a major portion of first-time home buyers and are particularly susceptible to affordability problems. Numbers of young adults are projected to remain at the highest levels in history, about 60 million, through the 1980's and early 1990's. Demand for homeownership among young adults is also projected to remain at peak levels. This is almost entirely due to the large number of young adults. We do not project significant increases in homeownership rates.

On the basis of demographics and preferences, there will be large numbers of young adults who would like to own their own homes. They may not be able to achieve this goal unless there are adequate supplies of affordable housing and unless appropriate financing options are available.

FHA support for innovative financing methods could make an important contribution in this arena. In order to meet national housing needs, construction of new units is only one way in which we can increase the supply of housing. More intensive utilization of existing stock through rehabilitation, renovation and conversion also adds to the total amount of available housing. Reliance on these processes also has the desirable effect of reducing the share of our national resources that have to go into meeting our housing needs. Net removables, which constitute replacement demand for housing, seem in recent years to have fallen well below the levels observed in the 1950's and 1960's. Economic factors are likely to hold removals relatively low while encouraging more rehabilitation and conversion.

This is, however, difficult to confirm empirically since there's very little hard data in this area.

Facilitating rehabilitation and conversion, particularly in inner cities, by making financing more readily available, as would be done by several of the provisions of S. 1702, will promote more efficient use of capital already invested in housing.

MANUFACTURED HOMES

Manufactured homes offer an increasingly important alternative form of affordable housing. With the development of improved technologies and multisection units, manufactured homes are now functionally and visually comparable to conventional housing. Manufactured homes have accounted for 25 to 30 percent of sales of single family detached houses since 1975. Their share in 1981 may be as high as 40 percent since manufactured home sales are expected to be up by at least 10 percent while conventional housing starts are extremely depressed. In fact, according to today's newspaper, single family starts are now at 487,000, the lowest level in the entire postwar period.

VA and FHA title I programs are currently being used in financing about 13 percent of the sales of manufactured homes, a fraction which has nearly tripled since 1975. Adequate financing for manufactured homes has been more difficult to obtain, however, because FHA title II insurance has not been available. In many instances, the lack of this insurance has forced buyers to obtain funds through consumer loans rather than through mortgages. FNMA and the Federal Home Loan Bank Board have recently modified their procedures to recognize that mortgages on manufactured homes are acceptable risks and can be handled like mortgages on conventional homes. It is appropriate and desirable for the FHA to also treat manufactured homes as it does conventional housing, as is proposed in S. 1702. Thank you.

[Complete statement follows:]

STATEMENT OF DAVID T. KRESGE, DIRECTOR, JOINT CENTER FOR URBAN STUDIES OF MIT AND HARVARD UNIVERSITY

FUTURE HOUSING DEMANDS AND THE FHA REVITALIZATION ACT OF 1981

Introduction

For more than three decades we have seen steady advances in the size and quality of the nation's housing stock. Expansion was fueled first by the pent-up demand in the years after World War II, and secondly, by the need to replace large portions of the existing stock. More recently, increases in the number of households and gains in income have been the primary forces driving up demand. The extensive progress we have achieved in housing production and in meeting the nation's housing needs has been aided significantly by at least five major types of federal policies:

A tax system that gives incentives to homeownership and expanded housing consumption;

A mortgage credit system that, until recently, provided relatively cheap long-term credit for home purchases;

Federally supported secondary mortgage institutions;

Tax incentives to investors to encourage real estate development; and

Federal highway and transportation policies that opened vast areas to residential development.

Many of these policies encouraging housing development are still in place and the underlying assumptions and values are still widely supported by government leaders and the general public. Owning a home, for example, remains a high valued goal for most American families. There is still concern for making sure that housing is available at a cost of a type and in a location that meets the needs of a broad spectrum of households. Finally, there is concern that the construction and finance

industries, which have been crucial to past advances in housing, remain healthy and capable of meeting future housing needs.

While housing policies have been successful in achieving many of their original objectives, there is still legitimate concern as to how housing needs will be met in the years to come. There are a number of factors which will determine how much further housing progress we will be able to achieve through the year 2000. One which is of paramount importance is the nature of housing demand. Between now and the end of the century some profound changes will occur in the forces which shape housing demand. We will observe changes in the number and composition of households which will in turn affect the number and types of housing units being demanded. Certain population groups and certain areas will face particularly pressing problems concerning the availability and affordability of adequate housing.

The Harvard-MIT Joint Center for Urban Studies has a continuing research program which focuses on the economic and demographic forces affecting housing demands. This report draws on that work to examine the prospects for future housing demands and particularly the demands for homeownership. We then go on to look more specifically at the housing needs of young adults, a population group which accounts for a major portion of first-time homebuyers and a group which is particularly vulnerable to affordability problems. Next, we look briefly at how rehabilitation and conversions are being used increasingly as a supplement to new construction. Finally, we examine in some detail the role of manufactured homes as a potential source of adequate, affordable housing.

Projections of population and households

The amount of housing required in the United States is ultimately determined by the size of the nation's population but it is the number of households which more directly determines the level of housing demand. Projections of future housing demand involve both the estimation of total population growth and of household formation patterns. The propensity of adults to form households, which is termed the "headship rate," and changes in the average household size play critical roles in determining the total number of housing units needed. For example, any increase in headship rates accompanied by a decrease in average household size will push up housing demand even with no increase in the size of the total population.

The rate of household formation is influenced by a variety of economic, social, and demographic forces. Economic conditions will, for example, influence the behavior of young people in deciding whether to get their own apartment or to continue living in their parents' homes. Lifestyle factors also influence both the number and structure of households. The decisions to delay marriage or to have fewer children affect headship rates and change the size of the average household. The effect of economic factors is compounded by the fact that as people move through different stages of their life cycles they have different housing needs, preferences, and abilities to pay. Gains in income have pushed up headship rates by allowing groups such as the elderly and the divorced to act on their preferences for independent housing.

These factors have combined to produce extraordinarily rapid increases in the number of households in recent years. This has been in part the result of a growing number of young people in the baby-boom generation who reached adulthood in the 1970s during a time of rapidly expanding economic opportunity. This first produced a surge in the demand for rental housing in the early 1970s. Then, as the baby-boom generation matured, this was transformed into strong demands for homeownership during the latter part of the decade.

These trends are clearly reflected in the statistics for household formation. The annual increase in the number of households grew dramatically from an average of 927 thousand households per year in 1960–1965 to a high of 1.7 million households per year between 1970–1975. From 1960 through 1975 the number of households increased at an annual rate of 2.0 percent, greatly exceeding the rate of growth in total population over that same period, which averaged about 1.1 percent per year.

On the basis of detailed analysis of individual population groups we project that the rate of household formation through the mid-1980s will run at about 1.3 to 1.4 million new households per year, a rate just slightly below that experienced in the past decade. By the end of the 1980s, however, the rate of household formation will begin to fall off dramatically and we project the decline to accelerate as we move toward the end of the century. We expect that by the year 2000 the rate of household formation will be approaching 800 thousand per year, even lower than the rate in 1960 and only about half the rate in recent experience. This markedly lower rate of household formation will necessarily be associated with slower growth in potential housing demand.

Potential demand for homeownership

A critical aspect of housing demand involves the decision whether to own or rent. In our work we project a split between owners and renters on a basis of detailed analysis about the behavoir of individual population groups at different stages in their life cycles. In making our projections we take into account the trends towards higher levels of homeownership observed in the early 1970s but we feel that there will be some moderation of the extraordinarily rapid increase in ownership rates seen between 1975 and 1980. We feel that a substantial portion of the increase in homeownership during the late 1970s was attributable to speculative investment in housing caused by high inflation rates. With inflation finally starting to abate, speculative investment in housing should also become a less important factor. The recent sluggish growth of real personal income, high interest rates, and increased housing costs, will also act to retard any movement toward higher homeownership rates.

Our projection of future housing demands and of the potential homeownership demand is shown in Figure 1. It must be stressed that these are potential demands which implicitly assume that economic conditions and housing costs will return to levels more nearly similar to past experience. If the current high interest rates and affordability problems persist it is possible, indeed likely, that far fewer households will be able to afford to own their own home. In fact, if housing costs are sufficiently high this will hold down the rate of household formation and will thus reduce total number of housing units that will be required. The projections in Figure 1 should be interpreted as showing, on the basis of demographic factors and historical preferences, how many homes people would like to buy if they can afford them.

Two key points emerge from the projections. First, the projected fall off in the rate of houshold formation is reflected primarily in a sharp decline in the demand for additional rental units. Recent data indicates that the demand for rental units has already begun to slow down and we project that the decline will accelerate through the 1980s and 1990s, and by the end of the century the demand for additional rental units will have fallen nearly to zero. By comparison, nearly 400 thousand rental units per year were being added during the late 1970s. It should be noted that the projections do not refer to the number of rental units actually being occupied but to the net number of additional rental units required. Thus, our suggestion of negligible net rental demand toward the end of the century does not imply that there will be no renters, only that there will be no need to construct additional rental units.

The second point is that the demand for owned units is projected to fall much more gradually from a peak of 1.2 to 1.3 million units per year during the 1970s to about 1 million units per year during the 1980s, and then to perhaps 800 thousand per year by the end of the century. This sustained demand for homeownership is largely attributable to the movement of the baby-boom generation through different stages of the life cycle. During the 1980s and early 1990s the baby-boom generation is moving through the prime homebuying ages and that tends to bolster the demand for homeownership, even though the overall rate of household formation is declining sharply.

Homeownership demands of young adults

Young adults (referring here to those under the age of 35) face particularly difficult housing decisions and problems. Young adulthood is a stage in life when major decisions are made with respect to household formation as well as homeownership. In recent years there has been an increasing tendency for young people to set up their own household. Increase in headship rates in this age group was a major development in the 1970s as more young people chose to live independently. The rise in headship along with the expanding population in this age group were important factors pushing up housing demands during this period.

This is also the stage of life when a large proportion of people become homeowners for the first time. Increasing rates of homeownership among young adults was a noteworthy phenomenon of the 1960s and 1970s. The rate of homeownership among those under 35 years old rose from 30 percent in 1960 to 42 percent in 1980. A remarkable number of young people were able to acquire their first home despite rising house prices and high interest rates.

The size of the young adult population increased dramatically during the 1960s and 1970s. The increase in sheer numbers, together with the rise in homeownership rates, meant that young adults provided a major stimulus to housing demands during that period. Between 1960 and 1980 the number of young adults doubled while the number of young adults who owned their own homes tripled. As a result, the share of the nation's housing stock owned by those under the age of 35 doubled during that period, going from 12 percent in 1960 to 24 percent in 1980.

As shown in Figure 2 the young adult population is projected to remain at the highest levels in history over the decade of the 1980s. After increasing from 49.8 million in 1975 to 58.4 million in 1980, the young adult population is projected to remain above 60 million through the 1980s and then to decline to 51.7 million by the year 2000. The at first gradual and then more rapid contraction is attributable to the maturing of the baby-boom generation and the smaller size of succeeding cohorts.

We project the numbers of young-adult households and homeowners to follow much the same pattern as population. As shown in Figure 3, we project the number of potential homeowners among young adults to reach a peak of 12 million in 1985, and then decline moderately to somewhat over 10 million by 1995. The projections do not assume any further significant increases in homeownership rates among young adults. The rate remains at somewhat under 50 percent throughout the period. That compares to a homeownership rate of nearly 75 percent for households over the age of 35.

These projections have two critical implications. First, the number of young adults is going to remain at peak levels well into the 1990s. Second, the potential demand for homeownership among this group is likely to remain very strong throughout the same period. The question is whether that potential demand will become a reality or whether a substantial proportion of these prospective first-time homebuyers will be unable to achieve their goals. It is quite conceivable that many of them will be unable to afford the type of housing they would like unless government policies are devised to assist first-time homebuyers.

One aspect of the affordability problem for young households is illustrated by the income data shown in the table below.

1978 Income by Age of Head of Household

All families	$20,091
Under 35	16,956
35–44	22,575
45–54	25,363
55–64	22,408
Average, 35–64	23,475
65 and over	13,754

In 1978 the average income for young families was only about $17,000; substantially below the national average of $20,000 and nearly 28 percent lower than the average for families in the 35–64 age categories. Clearly, the question of "affordable" housing is particularly critical for these young families. The problem is compounded by the fact that young families typically have relatively little accumulated wealth. Rising home prices, large down payments, and high monthly carrying charges are severe problems for young adults who would like to purchase their first home. This is a serious policy problem because as shown in the projections given above, the number of potential homebuyers in the young adult category is going to remain at historically high levels for some time to come.

Housing construction, rehabilitation, and conversion

For most of the last 30 years, housing starts have exceeded new household formations by a substantial gap, as shown in Figure 4. This difference between housing starts and the increase in households is largely attributable to replacement demand or removals. During the 1950s and the 1960s, net removals averaged more than one-half million units per year due to a combination of factors including, notably, the removal of dilapidated units and demolition related to land assembly for urban renewal and transportation projects. During the 1970s, however, conservation programs were put in place, rehabilitation and conversions from non-residential uses accelerated, and the stock of uneconomical or blighted housing had been reduced. As a result, net removals and therefore replacement demand had generally become smaller, though there were still wide short-run variations in the level of removals.

This closing of the gap between housing starts and household formation is attributable to a number of economic factors which have taken on increasing importance in recent years. High interest rates, shortages of developable land, and demand for housing close to urban amenities are all factors leading to more intensive utilization of the existing housing stock. It has become economical to rehabilitate or renovate existing housing units rather than to remove them. Conversions of non-residential units are also occurring in much more significant numbers than in earlier decades.

Large housing units both in urban areas and in the suburbs are being split into more than one unit. This process is of course facilitated by the trend towards smaller households. Both the conversions and the splitting lead to more housing units being created without the need for additional housing starts.

These economic and demographic factors seem likely to persist over the foreseeable future. It seems unlikely therefore that the gap between housing starts and the increase in households will return to the high levels observed in the 1950s and 1960s. Indeed, we project that the recent experience will be the pattern for the coming decade and perhaps longer. The incentives for more intensive utilization of the existing housing stock are likely to be with us for a long time.

To the extent that public policies can be devised to foster the improved utilization of the existing housing stock that will reduce the share of national resources that have to be used to meet housing needs. Clearly that is a desirable policy objective particularly in light of the need for putting a greater share of our investment into reindustrialization to increase productivity. Promoting greater use of rehabilitation, renovation, and conversion may be a very cost-effective way of augmenting our usable housing stock. To the extent that these processes are inhibited by lack of adequate financing mechanisms, it is worthwhile to try devising creative ways of providing more adequate financial support.

Manufactured homes

Another way of adding to the stock of affordable housing is by augmenting conventional housing starts with manufactured homes. The housing starts data reported in Figure 4 include conventional units only, manufactured housing units are not included. When a larger proportion of total housing demand is met through manufactured homes, fewer conventional starts are required to provide shelter for the additional households being formed.

With the requirements of the HUD Code assuring the quality of their construction,today's manufactured homes are an integral and increasingly important part of the shelter industry. With starts of conventional homes down dramatically, currently running at annual rate of less than one million units, sales of manufactured homes are up by 13 percent over the previous. year. It is estimated that about 250,000 manfactured homes will be built and occupied in 1981, accounting for more than 20 percent of all new housing units constructed in the U.S. during the year. Since 1965 there have at least 200 thousand manufactured homes built each year, and since 1975 manufactured homes have constituted between 25 and 30 percent of all new single-family detached houses, with 1981 estimates of this being as high as 40 percent (Tables 1 and 2).

Manufactured homes are complete housing units brought to the housing site on their own chassis and wheels in one or more sections. About 70 to 75 percent of recent units are single section with the remainder consisting of two or more sections. The typical single-section units range from 700 to 1,050 square feet with layouts ranging from one bedroom and one bath, to three bedrooms and two baths. Typical multi-section homes range from 1,000 to 1,500 square feet with layouts ranging from two bedrooms and one bath, to three bedrooms, family room and two baths. A substantial proportion of units are built with shingled roofs and various conventional "house-type" sidings. Only a few percent ever move other than from plant to homesite. In short, the contemporary manufactured home is of a size, style, and appearance which is consistent with the standard inmage of an American home.

If the layout and appearance of manufactured homes have changed, so also has the profile of the typical occupants. Unfortunately, Census definitions have not caught up with contemporary realities, rendering both Cenus and Annual Housing Survey data unreliable. Joint Center analysis of occupant profiles produces results dramatically different from the conventional wisdom. First, the standard image of manufactured homes being purchased either by very young or by very old households is not accurate. While young and old two-person households continue to be active consumer's of manufactured homes, households of three or more persons with the age of the household head being between 35–54 are a steadily growing market segment. It is also the segment which has the highest median income. The 1978 survey of manufactured home buyers found 35–54 year old heads of households to have a median income of $17,588, with nearly 40 percent having an income of $20,000 or more. Household heads under 35 had a median income of $15,113 with those 55 and over at $12,050. Overall, the income and related socieoconomic characteristics of recent manufactured home buyers are not very different from the general U.S. profile. It seems clear that manufactured homes are increasingly an option perceived by potential buyers as meeting conventional needs.

Manufactured housing financing activity has increased substantially over the past few years. From 1976–1980, the total value of manufactured home retail paper outstanding increased from $14.2 billion to $17.4 billion. In 1980 the distribution by type of lending institution was: commercial banks 59.9 percent, finance companies 31.6 percent, S & Ls 15.8 percent, and federal credit unions 2.7 percent. The increase in the amount of manufactured home loan activity is even more pronounced for FHA and VA. In 1975, for example, the FHA Title 1 program accounted for 3.7 percent of units, the VA for just 0.8 percent. In 1980 FHA Title 1 program was used for 9.8 percent of the units, with the VA program covering 3.6 percent. That is a near tripling of the combined proportion for the two programs since 1975. Since these loans are eligible for purchase in GNMA mortgage-backed securities programs (and indeed well over 90 percent is sold this way), it is apparent that these financing mechanisms can and do work successfully in making financing more readily available for purchasers of manufactured homes. Further, given the dramatic increase in the proportion of units financed using the FHA and VA programs, it seems that the housing consumer and the financing institutions perceive these traditional home mortgage aids as providing worthwhile assistance in the purchase of manufactured homes.

FHA Title II insurance programs, however, have not been made available for the purchase of manufactured homes. The absence of FHA Title II insurance makes it more difficult to obtain mortgage financing for manufactured homes. Instead, prospective buyers often have to resort to consumer loans to finance the purchases. Since consumer loans have shorter maturities and carry higher interest rates than mortgages, the monthly carrying charges are substantially higher than for mortgages. Or, if the purchaser is able to obtain a conventional mortgage, this will usually require a substantially larger downpayment than would an FHA mortgage. One result of the higher monthly cost and/or higher downpayment is to force potential buyers of manufactured homes to choose lower-priced, less adequate homes than they would otherwise prefer, and less adequate than they could afford if FHA mortgages were available. One effect of this is reflected in the statistics on manufactured homes which show that the proportion going into the more expensive, multisection units has been decreasing over the past two years, with estimates suggesting an even larger drop for 1981. Our analysis suggests that this is in part due to the absence of adequate financing, especially in terms of lower downpayments for these more expensive units. Thus, by forcing consumers to select lower-priced units, the absence of FHA financing reinforces the stereotype of manufactured homes as "trailers," rather than as affordable alternatives to conventional-built homes.

In terms of risk, the available evidence indicates that mortgages on manufactured homes are comparable to those on conventional-built homes. The Federal Home Loan Bank Board conducted an in-depth study of the risk associated with mortgages on manufactured homes based on the lending experience of federally and state-chartered S&Ls. The study concluded that the traditional perception of high risk associated with manufactured home lending was not supported by the evidence. This was particularly true with regard to lending for manufactured homes on permanent foundations where the risk did not differ from comparable conventionally built single-family housing. Based on this study, the Federal Home Loan Bank Board in 1979 liberalized the regulations on S&L lending activities for manufactured homes. These changes were aimed at allowing an expanded manufactured home lending role for S&Ls by providing lower downpayments, longer maturities, and higher commitment of assets.

The increasing acceptance of mortgages on manufactured homes was strongly reinforced this past August by FNMA's announcement that, in its secondary market purchase program, mortgages on manufactured homes on permanent foundations will be accepted on a par with mortgages on site-built houses. This was a clear affirmation by this major institution in housing finance that manufactured homes are acceptable risks. More importantly, by providing a secondary market for mortgages on manufactured homes, FNMA has made them a much more attractive investment for lending institutions.

On the basis of the available evidence and in light of the actions taken by other institutions, there is little reason for FHA to treat manufactured homes differently from other types of housing. Since manufactured homes offer a technologically sound and often more afforadable form of housing, potential buyers should have access to the same financing options as they have for conventional homes.

Summary

Any evaluation of housing policies such as those proposed in S–1702 has to be set in the context of the potential housing needs over the coming years. On the basis of

work done at the Harvard/MIT Joint Center for Urban Studies, we anticipate that future housing markets will be characterized by the following conditions:

Household formation will run at about 1.3 to 1.4 million new households per year through the mid-1980s, a rate only slightly lower than that experienced during the past decade.

Household formation will fall off sharply by the late 1980s and early 1990s and by the year 2000 may be approaching only 800 thousand per year, which is even lower than the rate in 1960 and only about half the rate in recent experience.

Demand for rental units will fall off sharply due to the declining rate of household formation. By the end of the century, there will be almost no need to construct additional rental units.

Demand for homeownership will, at least potentially, hold up through the 1980s and early 1990s. Demand will be sustained by the movement of the baby-boom generation into the prime homebuying ages. This assumes that severe affordability problems do not force potential buyers to change their plans.

Within this context, the housing demands of young adults are of particular relevance to the purposes of the proposed legislation. Young adults (under age 35) account for a major portion of first-time homebuyers and are particularly susceptible to affordability problems.

Numbers of young adults are projected to remain at the highest levels in history (about 60 million) through the 1980s and early 1990s.

Demand for homeownership among young adults will also remain at peak levels. This is almost entirely due to the large numbers of young adults; we do not project significant increases in homeownership rates.

On the basis of demographics and preferences, there will be large numbers of young adults who would like to own their own home. They may not be able to achieve this goal unless there are adequate supplies of affordable housing and unless appropriate financing options are available.

Construction of new units is only one way in which we can increase the supply of housing. More intensive utilization of the existing stock through rehabilitation, renovation, and conversion also adds to the total amount of available housing. Reliance on these processes also has the desirable effect of reducing the share of our national resources that have to go into meeting our housing needs.

Net removals, which constitute the replacement demand for housing, seem in recent years to have fallen well below the levels observed in the 1950s and 1960s.

Economic factors are likely to hold net removals relatively low. However, this is difficult to confirm empirically since there is very little hard data on net removals.

Manufactured homes offer an increasingly important alternative form of affordable housing. With the development of improved technologies and multi-section units, manufactured homes are now functionally and visually comparable to conventional housing.

Manufactured homes have accounted for 25 to 30 percent of sales of single-family detached houses since 1975. The share in 1981 may be as high as 40 percent, since manufactured home sales are expected to be up at least 10 percent while conventional housing starts are extremely depressed.

VA and FHA Title I programs are used in financing about 13 percent of 1980 sales of manufactured homes, a fraction which has nearly tripled since 1975.

Adequate financing for manufactured homes has been more difficult to obtain because FHA Title II insurance has not been available. In many instances, buyers have had to obtain funds through consumer loans rather than through mortgages.

FNMA and the Federal Home Loan Bank Board have recently modified their procedures to recognize that mortgages on manufactured homes are acceptable risks and can be handled like mortgages on conventional homes.

It is appropriate and desirable for the FHA to also treat manufactured homes as it does conventional housing—as is proposed in S. 1702.

Figure 1

AVERAGE ANNUAL INCREASE IN NUMBER OF OWNER AND RENTER HOUSEHOLDS

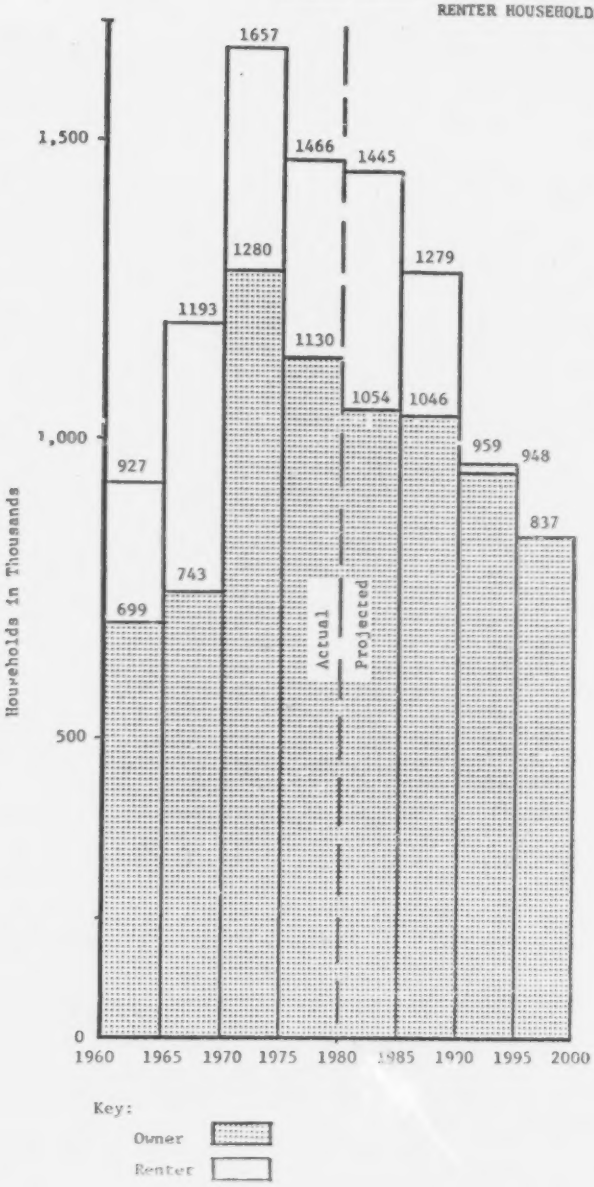


Figure 1 SOURCES: 1960 Census of Population and Housing
1966 Survey of Economic Opportunity
1970 Census of Population and Housing
1975 Annual Housing Survey
1980 Current Population Survey
and 1979 Annual Housing Survey
1985-2000 Projections,
Harvard-MIT Joint Center for Urban Studies

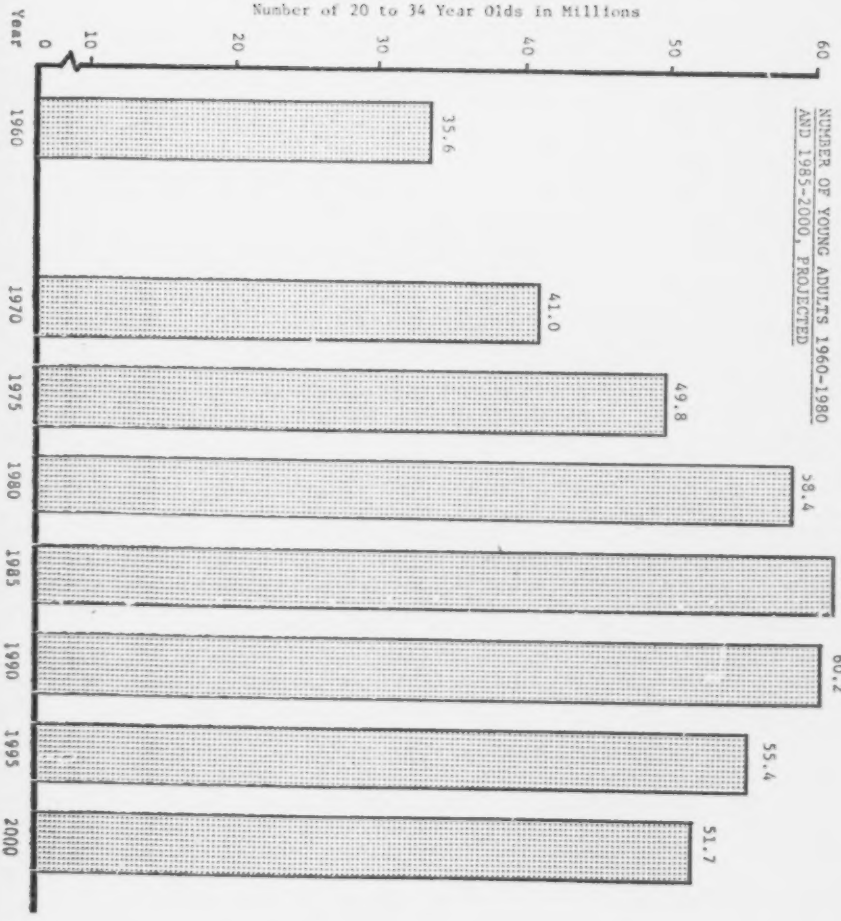
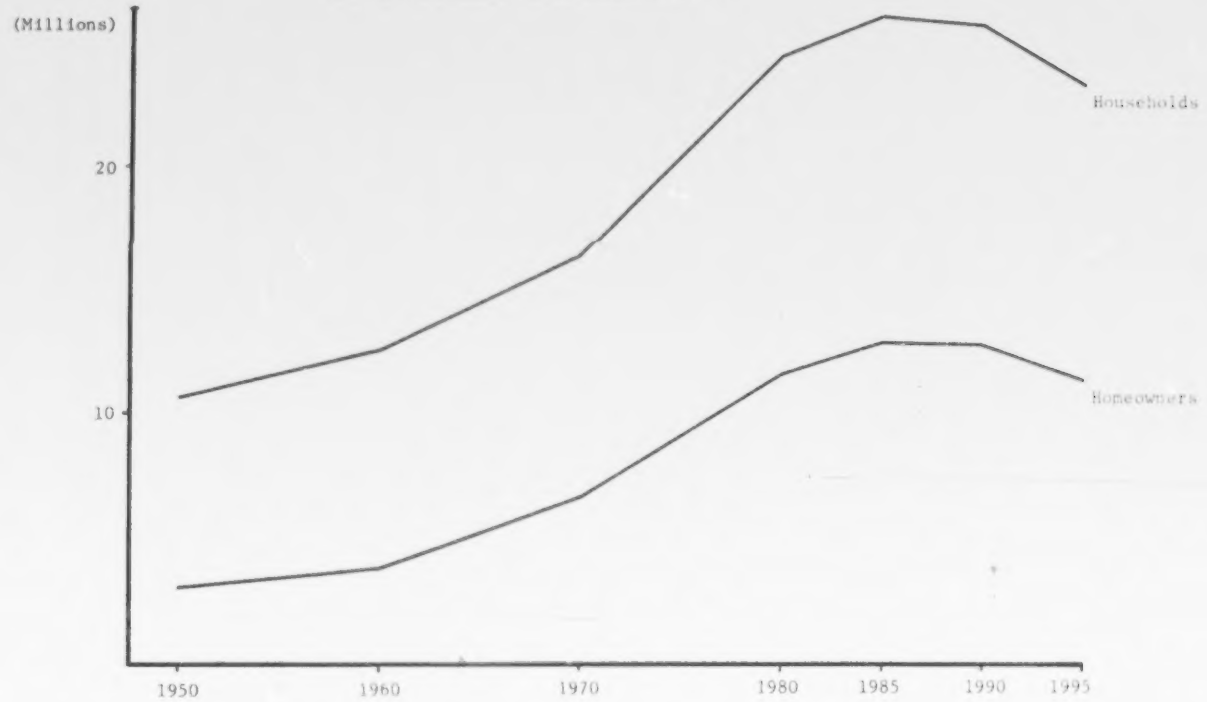


Figure 2

Figure 2 SOURCES:

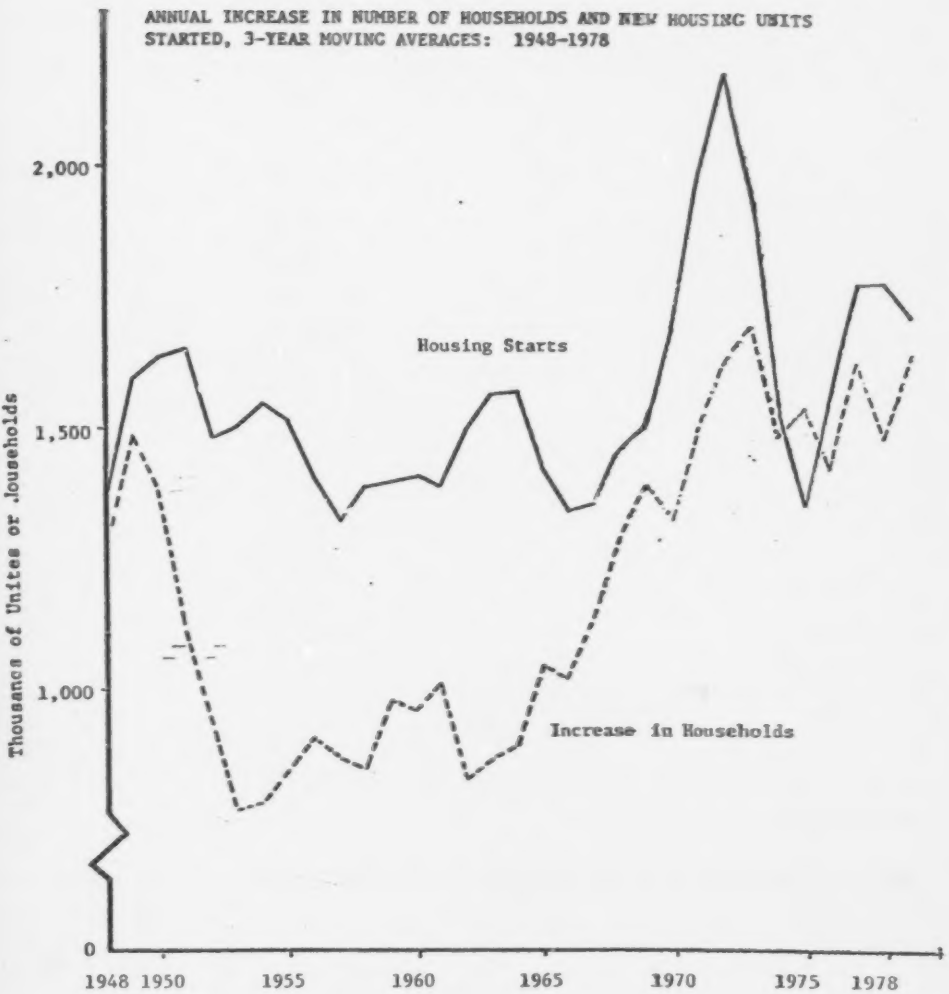
1960 Census of Population and Housing
1970 Census of Population and Housing
1975 Annual Housing Survey
1980 Current Population Survey
1985-2000 Projections,
Harvard-MIT Joint Center for Urban Studies

Figure 3: HOUSEHOLDS AND HOMEOWNERS UNDER AGE 35: HISTORICAL DATA AND PROJECTIONS TO 1995



SOURCES: U.S. Bureau of the Census.
Projections from Joint Center for Urban Studies of MIT and Harvard University.

Figure 4



SOURCES: U.S. Bureau of the Census, Current Population Reports and Construction Reports (adjusted for farm housing built 1948-1959).

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TABLE 1.—MANUFACTURED HOME SHIPMENTS AND ESTIMATED SALES VOLUME, 1950–80

[Dollars in millions]

Year	Shipments	Estimated retail sales
1980	221,097	$4,245
1979	276,121	4,860
1978	274,901	4,378
1977	265,145	3,765
1976	246,120	3,136
1975	212,690	2,432
1974	329,300	3,213
1973	566,920	4,406
1972	575,940	4,002
1971	496,570	3,297
1970	401,190	2,451
1969	412,690	2,496
1968	317,950	1,907
1967	240,360	1,370
1966	217,300	1,238
1965	216,470	1,212
1964	191,320	1,071
1963	150,840	862
1962	118,000	661
1961	90,200	505
1960	103,700	518
1959	120,500	602
1958	102,000	510
1957	119,300	596
1956	124,330	662
1955	111,900	462
1954	76,000	325
1953	76,900	322
1952	83,000	320
1951	67,300	248
1950 [1]	63,100	216

[1] Prior to 1950, production varied from 1,300 in 1930 upward to 46,200 in 1949.

Source: Manufactured Housing Institute, 1981.

TABLE 2.—COMPARISON OF MH SHIPMENTS AND SALES OF SINGLE-FAMILY SITE-BUILT HOUSES, 1975–80 [1]

	1975	1976	1977	1978	1979	1980
Site-built houses:						
Houses sold	550,000	647,000	820,000	817,000	709,000	531,000
Percent of total	72	72	76	75	72	71
MH's:						
Houses shipped	212,690	246,120	265,145	274,901	276,121	221,000
Percent of total	28	28	24	25	28	29
Total new, one-family, site-built houses sold and MH's shipped	762,690	893,120	1,085,145	1,091,901	985,121	725,000

[1] All prices.

Source: Manufactured Housing Institute.

Senator LUGAR. Thank you very much, Mr. Kresge. I would say at the outset how much this subcommittee has appreciated the work of the Joint Center for Urban Studies during the past few years. The contribution has been enormous and your presence here today is especially helpful and your entire statement, of course, will be published in the record in full.

I would like to ask these questions. Is it reasonable to meet the needs of the first-time buyer with new production or should we expect to see those needs met with used homes as current owners improve their housing or I suppose, more appropriately, in what mixture do you foresee that we can best meet the housing needs of Americans?

Mr. KRESGE. I think with the exception of manufactured homes, it will be surprising to find first-time home buyers going into newly constructed units. However, I think that exception is a very important one and manufactured homes do in fact offer a very attractive alternative even for the first-time home buyer.

I think anything that can be done to make it easier to convert or rehabilitate existing units will also facilitate homeownership for first-time buyers.

Senator LUGAR. Concentrating on first-time buyers for a moment more, let me ask you the same question essentially that I ask Secretary Winn. Do you feel that first-time and marginal buyers should be the focus of FHA and should that focus be an exclusive one?

Mr. KRESGE. I don't think it should be an exclusive focus. I think there are other groups that FHA could also arguably be supporting. But I think it's a very important focus of FHA because I agree with Secretary Winn that FHA should not be in the role of doing things that the private sector already does reasonably well; that it should be focusing on problems and innovations and aspects of the market that are not currently being supported adequately by the private sector; and the first-time home buyer is certainly one of the very, very important elements.

Senator LUGAR. You have a great deal of experience as an economist as well as a housing expert. From that experience and given the current situation, in your judgment, would a Brooke-Cranston or other mortgage substitute program be appropriate or desirable at this time?

Mr. KRESGE. I'm reluctant to support anything like that, particularly in the present fiscal situation where we have very, very limited funds available to the public sector. I think the Government has a very important supportive role to play, but actually taking scarce resources—dollars—and putting them directly into support programs strikes me as not the most efficient use of the Government's support.

FALLING INTEREST RATES

Senator LUGAR. As interest rates fall, do you expect to see a rapid runup in housing prices?

Mr. KRESGE. To answer that, I'd have to ask you how far do you want to let them fall? If mortgage rates fell to 10 or 12 percent, you would see a phenomenal market for home building. On the other hand, if they only fall to 15 percent, you will undoubtedly see housing come out of its currently extremely depressed situation, but I doubt that you would find an extreme boom.

Unfortunately, I have some reservations on whether the so-called pent-up demand actually is out there in the magnitude that some homebuilders would hope. I'm afraid that our recent unfortunate

experience in housing is likely to have eliminated some of that demand rather than simply deferred it. Some of it is surely pent up, but I think some of it has probably been lost entirely.

Senator LUGAR. Could you expand on that further? Where would that loss have occurred? You say our recent experience in housing may have dissipated some of the demand.

Mr. KRESGE. I think we will have persuaded people to form different kinds of household structures than they otherwise would have chosen and we won't find them going back to independent living and homeownership in the same numbers that they would have under different economic conditions. We will find that there is in fact going to be a continuation of more doubling up and different types of households than we otherwise would have found and the reversion to the previous trends will not be complete. So we will have deterred some people from independent households who otherwise would have chosen to do that.

Senator LUGAR. Well, has this deterrence been a function of the price of housing or are you suggesting simply this period in which there was relatively low buying power have led people to make these arrangements and were found satisfactory and thus will continue in them?

Mr. KRESGE. I think it is, of course, a reflection of the cost of housing. That is what forced them to do it and that cost includes the interest charges as well as the price of the housing units. That is the driving force. And what I'm suggesting is whenever we see people forced to do something they would not otherwise choose to do, they don't go back entirely to the trend they otherwise would have been on.

Senator LUGAR. Is the current situation in the housing industry and the attendant bankruptcies that have been produced over part of this period reducing our production capacity to such an extent that we will not be able to meet demand if interest rates should fall?

Mr. KRESGE. I don't think that is likely to be a serious problem unless interest rates should fall very precipitously, and we should therefore get a housing year which went up over the 2 million starts level. In that case, we would see some very severe bottlenecks in certain aspects of the industry, especially among some of the suppliers of the materials used in home construction.

One of the problems, as you know, with the housing industry is its so-called cyclical instability, and this has been a concern of studies of the joint center for some time, and there is no question that we all pay higher prices for housing as a result of that cyclical instability. We force the housing industry to organize itself in such a way that one year it's constructing 900,000 units and a few years later it's constructing 2.2 million units. That simply is not the most efficient way to operate an industry and necessarily it pushes up the cost of housing.

Senator LUGAR. In your response you just mentioned the level of 2 million units as a trigger point for very real difficulties in meeting demand. Is that a considered figure or is it an approximate one or how would you characterize when things begin to go askew, given the number of suppliers presently left?

Mr. KRESGE. Well, I was thinking particularly of materials suppliers but, of course, the contractors and builders are another aspect of the problem which is very real. The figure is a semiconsidered figure. It comes out of conversations I have recently been having with my friends in the homebuilding and supplying industries, and they indicate if there was a sharp runup to that level of construction they would be very hard pressed. Insulation and wallboard and other kinds of materials used in the production of housing would run into bottlenecks if there was a runup to that level, they feel, in the short run.

Now, of course, if the housing industry would promise to run at that level for a longer period of time, there would be no problems. These are short-run bottlenecks, not long-run, continuing problems.

NEW RENTAL PRODUCTION PROGRAM

Senator LUGAR. If rental demand is falling, should we have a new rental production program for the poor or others?

Mr. KRESGE. Well, again, it's the same sort of issue as the young adults. If you target it specifically on particular population groups, I think one could make an argument that such a program is appropriate. At the same time, I do think it's important to recognize that the demographics virtually guarantee over the next 5 to 10 years the strong pressures on our rental housing stock will begin to abate, that we have in fact in recent years gone through a crisis in rental housing but that's because the baby boom generation was moving through the ages where they tend to choose rental housing. They are the very young people forming their first household and their choice is rental housing. That baby boom generation will shortly have passed through that rental stage and will be into the homebuying stage.

Senator LUGAR. Mr. Kresge, thank you very much for coming to testify today and for your very thoughtful answers. We appreciate you coming.

Mr. KRESGE. Thank you.

Senator LUGAR. The Chair would like to call now upon our first panel, Paul Barru, representing National Association of Homebuilders; Robert L. Waldo, representing Mortgage Insurance Companies of America, accompanied by Claude Pope, American Mortgage Insurance Co., Raleigh, N.C.; Willard Gourley, Jr., representing Mortgage Bankers Association of America; and it's a special pleasure for the Chair to recognize John Hart, representing the Indiana Homebuilders Association. As all of us know, John has served in many, many national capacities and is an elder statesman, at least in my experience, in the housing area, and we are grateful that you are here this morning.

Gentlemen, would you proceed in the order that I've introduced you? First of all, Mr. Barru, then Mr. Waldo, and then Mr. Hart.

STATEMENT OF PAUL BARRU, REPRESENTING NATIONAL ASSOCIATION OF HOMEBUILDERS, ACCOMPANIED BY ROBERT D. BANNISTER, SENIOR STAFF VICE PRESIDENT FOR GOVERNMENT AFFAIRS; AND JIM SCHUYLER, STAFF VICE PRESIDENT AND LEGISLATIVE COUNSEL

Mr. BARRU. Senator, thank you very much for the invitation to come here and speak on behalf of the National Association of Homebuilders.

I'm a homebuilder from Grand Junction, Colo. I build primarily for the first-time homebuyer. I also happen to be vice chairman of the Standing Committee on Mortgage Finance of the National Association of Homebuilders and chairman of its Single Family Subcommittee. In coming here today with Bob Bannister, our senior staff vice president for government affairs, and Jim Schuyler, staff vice president and legislative counsel, I come frankly very pleased that someone in the administration and in the Senate has finally come forth with a constructive and creative and I believe very comprehensive program to address the ills that plague our industry.

I have a statement that I will submit for the record, but I'd like to speak off the cuff, if I may.

Senator LUGAR. Yes, of course.

Mr. BARRU. Our market has a shortage of housing stock, both rental and sale housing. It is a growth marketplace. Energy is impacting us. We have a lot of people coming in and these people do not have a great deal of capital with which to buy housing.

PRIVATE CAPITAL BEING SOPPED UP BY INDUSTRY

We have been seeking to address the housing need in a place where there is no private capital. The private capital has been sopped up by industry that is building mine shale development and a great many other things on a competitive basis that makes it impossible for the homebuyer to deal with the problem.

As a result, builders in our marketplace have been scrambling for alternative ways of financing housing for a long time and many of the things that you're suggesting are issues that we have been trying for 2 or 3 years to address.

Let me begin first with the issue of FHA. In our marketplace, as of yesterday, FHA was a full point and a half below the marketplace of conventional money, when conventional money was available. Frankly, most of the time it is just not available to us. It is certainly the only source for a fixed-rate 30-year mortgage. It is certainly the only source for a graduated mortgage payment. It is the only source that has even a hope of affordability for our people. Therefore, anything that will keep FHA as a vital force in the marketplace is absolutely essential for not only the first-time homebuyer but also for the moderate income job transferee that is coming out of job-depressed areas into growth areas such as our own and who do not bring great capital, who have not been able to liquidate their housing and have the opportunity to bring large downpayments and big salaries to bear on their housing needs.

I think the history of FHA—and it is the one thing that I think needs to keep being brought out—the history of FHA, in addition

to providing a 30-year, fixed-rate mortgage, does exert a pressure on moderating both the severity of increases in the mortgage market and it accelerates the decline when mortgages go down.

Four weeks ago FHA was at 17.5 percent. Today it's at 15.5 percent. The conventional money market in Grand Junction is still at 16.75 to 17.5 percent, the same place it was at approximately 4 weeks ago, Senator. I think that speaks for itself in terms of the pressure of FHA.

CATCH-22 ON LAND LEASES

I'd like to address specific titles that you have in your program and the first one that really concerns me is the landlease, because working with FHA 3 years ago we innovated a test program on the marketability issue of FHA landleases. All of the secondary market instrumentalities have a catch-22 on landleases. If you're in an area that has them as common place, you can do them; and if you don't, you can't; and you can't prove the marketability issue until you do them. With the help of FHA, we put 140,000 houses on landleases under the very restrictive old program prior to Mr. Winn's September 15 edict. The history of these houses is that they have been resold without any problem. The secondary market has accepted the houses on landleases without any question and to the satisfaction of FHA we have proved the marketability issue is a bogus issue.

Landleases do have the ability to reduce the cost because they allow you to graduate the payments of the landlease without putting front-end money up at the beginning, which is a major problem for the affordability issue for homebuyers and for builders. Therefore, the affordability issue is really dealt with at the threshold through the landlease program.

We encourage that program but we think a secondary part of that program has got to be the authorization for GNMA to create pools of landleases in order to create the liquidity for homebuilders to continue putting houses on landleases. We also need to authorize FHA to be more realistic in their appraisal of landleases for the resale of the property to homeowners in the future, something at the moment their regulations do not allow.

A second point that we would like to stress very much is that the condominium program, the 234 financing through FHA, really does have to become a single family program and, as Secretary Winn rightly pointed out, taken out of the multifamily processing program. We commend you for putting this in your bill. It is absolutely essential for affordability.

And I think the final comment that I would like to make is that stick-built housing is still affordable. In our marketplace at least we are able to deal with the issue. Where we need help is on the codes, the MPS. If we can compete with the same codes as manufactured housing, we can compete with them on costs and we can provide affordable housing.

I think our industry needs both kinds of housing on an equal footing to provide affordability for the American public. Homeownership is still absolutely crucial, not only as an investment but for

the social stability of our country, and I really commend you for keeping FHA here to keep homeownership as a vital option.

Thank you for the opportunity and I will be happy to answer questions, sir.

Senator LUGAR. Thank you for your testimony, Mr. Barru.

[Complete statement follows:]

STATEMENT OF THE

NATIONAL ASSOCIATION OF HOME BUILDERS

before the

SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS

BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

UNITED STATES SENATE

on

S.1702 - FHA REVITALIZATION ACT OF 1981

November 19, 1981

Mr. Chairman and Members of the Subcommittee:

My name is Paul Barru and I am a homebuilder from Grand Junction, Colorado. I am Vice-Chairman of the Standing Committee on Mortgage Finance of the National Association of Home Builders (NAHB) and Chairman of its Single Family Subcommittee. I am testifying today on behalf of the more than 123,000 members of that Association. Accompanying me today are Robert D Bannister, Senior Staff Vice President for Government Affairs and Jim Schuyler, Staff Vice President and Legislative Counsel.

Mr. Chairman, I greatly appreciate the opportunity to appear here today to discuss the specific legislation you have introduced which would help restore the traditional role of FHA as innovator, prototype, and consistent provider of adequate credit at reasonable terms for a critical segment of the homebuying public. I believe that your legislation is significant for three important reasons. First, substantively, it will help FHA to restore its role as a vital force in housing, particularly for young first-time homebuyers and residents

of older urban areas. Second, strategically, this bill is part of a comprehensive legislative package which recognizes the need for additional sources of mortgage credit and has come to a most logical conclusion. We emphatically share your view that we must expand the pool of funds available in the secondary market by tapping the largest source of long-term capital in pension funds and profit-sharing plans. The bill that you introdced with Senator Hatch (S.1678) which is co-sponsored by Senator D'Amato of this Committee would remove the obstacles to private pension investment in residential mortgages and go a long way toward opening up that source of funds. This FHA bill recognizes that certain segments of the market need a restructured FHA to help provide a stable source of credit at affordable terms. And the third element of your strategy recognizes that we must restore the fiscal health and well being of those financial institutions serving the housing market. As you said in your statement introducing this bill, "As we develop new lending techniques and expand the secondary market we should be careful to protect the lending resources we already have." Mr. Chairman, reasonable people have differed on the best means of protecting the S&L industry, but we all agree on the long-term goal of restoring the viability of the thrifts. Third, and perhaps most important, symbolically, this legislation could not have been introduced at a better time. As you know, Mr. Chairman, these are the worst of times for the housing industry and the housing consumer. But at a time when housing is at its lowest production levels since World War II, there appears to be an uncoordinated but real political attack on the basic foundations of housing and housing finance. This is occurring just when a record number of young

families are about to enter the housing market. Needless to say, the combination of high mortgage interest rates, the overall condition of the economy and this attack on housing have badly shaken consumer confidence. Add to that the confusing proliferation of alternative mortgage instruments - the ARMs buildup - and you have a prescription for an extended slack period followed by a slow recovery at best. This bill is one of the few positive signs we have seen in a world where we have observed, "I'm not paranoid...they really are out to get me." We only hope that the momentum and forward motion generated by this legislation will continue to build and be part of an effective "counterattack" to promote homeownership and the need for a continuing government role through FHA and expansion of the secondary market.

Let me turn to the specific provisions of S.1702.

Title I provides broad authority for FHA to experiment with different types of mortgage instruments, and Title II specifically authorizes an FHA "Canadian-rollover" type of mortgage.

Mr. Chairman, we have not resisted the trend toward the development of adjustable interest rate and adjustable term mortgages in the conventional market. In fact, we have strongly urged FNMA and Freddie Mac to develop common standardized forms and move toward the development of a limited number of instruments which are acceptable to the consumer, the lending institution, and purchasers in the secondary market. I have attached a copy of prototype ARM instruments which were developed by a distinguished group of independent mortgage experts who meet as the Mortgage Roundtable, convened by NAHB. (Attachment "A"). As you are aware, the level of uncertainty and confusion in the marketplace today is devastating to home sales

and consumer acceptance of these instruments is variable at best. During this time, the FHA level payment mortgage and the graduated payment mortgage have been the only source of "calm" in the "storm." In fact, many of our builders have found FHA-insured and VA-guaranteed loans (with a builder buy-down of the interest rate) to be the only acceptable instrument to the potential homebuyer. When buyers are confused, they obey Homebuyer Rule No. 1 "Don't commit yourself to the purchase of a home with a mortgage instrument that your local real estate agent or builder can't explain in writing on one page and in under five minutes."

In fact, the investment community has far from abandoned the FHA level-payment program. Prior to the reduction of FHA interest rates last week, buyers were paying no points and mortgages were even being offered at a premium in some markets.

We would strongly urge that FHA continue as a source of long-term fixed-rate mortgages and that its experimentation be limited to those kind of instruments which use the fixed-rate mortgage as the base. We believe that the first-time homebuyer at the lower end of the market deserves the stability of a long-term instrument at all times during the financial and housing cycles.

This does not mean that innovative mortgage instruments could not be made available using a variant of the fixed-rate mortgage. The GPM, graduated payment mortgage, was a creative mortgage instrument initiated by Congress that has worked. These mortgages allow homebuyers to make lower payments during the early years of the loan. Although the new instrument ran into some resistance when first introduced, we are very pleased to see FHA end the 1/2% differential

interest rate for the GPM and lower the GPM rate to the FHA level-payment interest rate because delinquencies have been so low and investors are satisfied with its performance. We applaud this action and point to it as an example of the kind of creative financing for the first-time homebuyer that can work to help alleviate the affordability problem. It should be noted that there is very little GPM activity in the conventional market even though the basic GPM program is four years old and the 245(b) program is limited to first-time homebuyers and has a volume cap.

Mr. Chairman, one program which I am personally enthusiastic about and would be authorized under this Title is a "double buy-down" program. As you are probably aware, builders who are selling homes in today's depressed market are doing so by "buying down" the interest rate. In a double buy down program, the buyer and builder place funds in a pledged account with the lender. This pledged account with the builder's contribution lowers the borrower's out of pocket payment sufficiently for five years so that buyers can qualify with a significantly lower income. In addition to the lower qualifying income, the advantage of such a program over the adjustable rate mortgage is the predetermined annual increase in the mortgage payment providing the buyer with a certainty of payment levels. Most programs use a maximum of 7 1/2% annual increase in mortgage payments for five years, which is similar to the FHA GPM program and has proven to be affordable for young families with moderately increasing incomes.

Section 102 increases the loan limits on duplexes, tri-plexes and quadraplexes and would remove the anomaly in mortgage limits that assumed that second, third and fourth dwellings were considerably

cheaper than one dwelling units. This change is important for those localities that have promoted higher densities and generally more creative zoning techniques to help lower the cost of housing. It also more accurately refects the cost differential for meeting construction code requirements.

Title III substantially improves and makes workable the Section 234 condominium insurance program. It would remove the artificial impediments in the law and alleviate the battles facing builders when working with HUD on whether condominiums are multifamily or single-family projects. This title removes the unnecessary and counterproductive requirement that condominium units must be unsold for a year before an individual can get FHA insurance. It would also remove the application of the Davis-Bacon law to condominiums. Davis-Bacon does not apply to other single-family insurance programs and has destroyed the ability to build condominiums at affordable prices. This section also allows the builder to get a project loan for the condominium based on the value of all the units.

Title IV authorizes the Secretary to insure homes on leased land. Selling a home but leasing the land has become a creative source of financing that had been, until recently, allowed for FHA-insured mortgages only in areas where it was traditionally part of the normal course of business, such as Hawaii. However, such a program will not become a part of the "normal course of business" unless FHA insurance is available. The amendment would allow sales of FHA homes on leased land throughout the country. Such a step could reduce the cost of homeownership by as much as 20% in the important early years.

Recycling our housing stock has played a significant role in revitalizing our cities. The amendment in Title VI would encourage FHA involvement in inner city rehabilitation. We support this amendment that would allow homeowners to move into FHA homes that do not meet Minimum Property Standards but do meet local health and safety codes. The amendment, limited to buildings over 30 years old, would allow the homeowner to rehab his home during his residency, not before he moves in, which is the present FHA requirement. Generally, we believe local health and safety codes should replace the Minimum Property Standards. This amendment would allow FHA to participate in the common urban revitalization practice of moving into a home and doing the rehabilitation one room at a time.

FHA WISH LIST

This legislation does not represent our entire FHA wish list. First, we would support legislation to restore FHA and GNMA as demand programs with no cap on their level of activity. I will not belabor this point, which we have raised before this Committee earlier this year. Mr. Chairman, the FHA and VA programs continue to have an important place in a national housing effort, particularly as virtually the only source of low-downpayment fixed-rate mortgage and GPMs for the lower end of the market. The GNMA mortgage-backed security program is the essential secondary market for these loans and has financed almost three-quarters of these loans this year. I was shocked to read the Administration's statement accompanying its proposed cut of $20 billion in GNMA commitment authority. The cuts in government credit programs were designed to "provide the financial market equivalent of a $20 billion reduction in budget outlays."

The proposed cut in GNMA represents a cut in "commitments" -- not a cut in the actual level of activity. It in no way represents a cut in direct or indirect budget outlays. In any event, this bogus "cut" would certainly be discounted by the financial markets because of the depressed housing market ... and because it is just not true. Mr. Chairman, as you have stated, what is needed today is an expansion and strengthening of the secondary market, not a contraction in the level of activity.

Second, we would suggest expansion of the limited FHA negotiated interest rate program to permit a negotiated option for all FHA-insured mortgages.

Third, we support and encourage the present efforts within the Department of Housing and Urban Development to eliminate the FHA Minimum Property Standards. The NAHB Research Foundation has estimated that the added cost impact of MPS requirements for a minimal house could be as high as 8%. This is partly due to the fact the minimal house under the MPS would be larger with more features than a minimal house permissible under a building code. We recommend that HUD should accept the Council of American Building Officials one- and two-family Dwelling Code as an alternative to the MPS.

Finally, we would recommend reinstatement of the operative builder program to assist builders with inventories to reduce the interest rate burden of construction loans. The operative builder program allows builders of FHA-qualified homes to get an FHA interest rate loan while the home remains unsold and allows the builder to retire the existing construction loan that is pegged above the prime

rate. No restriction should be placed on the volume of mortgages or the mortgage amount. This program could do more to alleviate builder bankruptcies than any other short-term program.

Mr. Chairman, one final word regarding the current Federal Housing Administration. FHA, under the dynamic and thoughtful leadership of Commissioner Philip Winn, has made significant strides in improving the operation and management of the agency under trying and difficult times. Usually when we testify about FHA, we urge greater flexibility and simplification of the processing system and we complain about delays in processing time. Obviously, some of the "credit" for the improvement this year must go to the decline in construction activity. But much of the credit for increased flexibility and more efficient management should go to Commissioner Winn and his effective professional team at FHA. With your legislation, Mr. Chairman, FHA would be even more effective in helping to meet the housing needs of young families who are being priced out of the market and other segments of the population who are not being adequately served at the present time.

I appreciate the opportunity to present our views on this significant legislation, and look forward to working with the Chairman and your highly competent professional staff on further refinements in this bill.

I would be happy to answer any questions you have.

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MORTGAGE ROUNDTABLE SUGGESTED
ADJUSTABLE RATE MORTGAGE INSTRUMENTS

The four adjustable rate mortgage loan instruments that were perceived by the Mortgage Roundtable to be the best are presented by characteristics in the table below. They are variations of the Fannie Mae Programs 2 and 3.

	Interest Rate Index	Interest Rate Adjustment Period	Payment Adjustment Period	Maximum Interest Adjustment	Maximum Payment Adjustment
I	6 months	6 months	3 to 5 yrs	None	None
I-A	6 months	6 months	3 to 5 yrs	2% per year	None
II	6 months	1 year	1 year	None	None
II-A	6 months	1 year	1 year	2% per year	None

The four instruments were selected to narrow down the large range of instruments that are confusing all sectors of the mortgage market. These instruments should provide, more importantly, an opportunity to develop a stable secondary market in adjustable rate mortgages.

The index used to determine rate adjustments for all instruments is based on the monthly averages of weekly auction rates on 6-month United States Treasury Bills, published in the Federal Reserve Bulletin. An average of that published rate for a 6-month period preceding a rate change would be used as the actual index. This index was selected because it closely matches the current cost of funds to lending institutions.

Two interest rate adjustment periods were selected. In Plans I and I-A a six month adjustment period was selected, while in Plans II and II-A, a one year adjustment period was recomended. Differences arise because of the payment adjustment periods: in Plans I and I-A a 3 to 5 year adjustment in payment was chosen, and a one year period was accepted for Plans II and II-A. It was felt that the shorter interest rate adjustment in the longer term payment adjustment period instrument would provide more balance. The lender would receive a shorter period for interest rate adjustment in return for providing the consumer with a longer term fixed payment.

The maximum interest rate adjustment is the sole reason for the existence of Plans I-A and II-A. They are designed to meet the Comptroller of the Currency regulations for commercial banks which limit interest rate adjustments to no more than 2 percent per year. The Mortgage Roundtable generally agreed that the regulations affecting commercial banks should be brought into conformity with those affecting thrift institutions which were promulgated by the Federal Home Loan Bank Board. The dropping of interest rate adjustment limitations would eliminate the need for Plans I-A and II-A and reduce the number of recommended instruments to two. A reduction to two instruments would further reduce the confusion in the mortgage and financial markets and hopefully provide more stability.

All four plans would not call for maximum payment adjustment limits.

NATIONAL ASSOCIATION OF HOME BUILDERS
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FOUR MODEL MORTGAGE LOANS

DESIGNED BY MORTGAGE ROUNDTABLE

WASHINGTON, Aug. 6 -- To reduce confusion over the various types of new mortgage plans now on the market, the Mortgage Roundtable has developed four model adjustable rate mortgage plans that could reduce the smorgasbord of options available today.

The prototype mortgage plans included certain consumer safeguards as well as provisions that would satisfy lenders who originate loans and institutional investors who purchase mortgage loans on the secondary market, said Morgan Earnest, a home builder from New Orleans and moderator of the Mortgage Roundtable.

Organized by the National Association of Home Builders two years ago, the Mortgage Roundtable meets at least four times a year to exchange ideas and to identify problems in the rapidly changing world of mortgage finance. Its members include primary lenders, builders, institutional investors, mortgage insurance executives and experts from the secondary mortgage market.

Regulations for the adjustable rate mortgages issued by the Comptroller of the Currency, the Federal Home Loan Bank Board (FHLBB), the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA) state terms that vary considerably with respect to important features of the loans, such as adjustment periods, maximum increases in interest and negative amortization.

That, in turn, has created a record number of mortgage options that has left those who originate mortgage loans and trade in the loans on the secondary market scrambling to put together loan packages that will serve their needs and the needs of home buyers best.

Unlike conventional, fixed-rate home loans, the adjustable rate mortgages periodically raise or lower the interest rate, and, hence, monthly payments, according to the going cost of money as measured by various indexes.

As the situation now stands, the interest on some loans can be raised an unlimited amount over a given period of time, while others state maximum amounts. Some of the loans have payment caps. FNMA allows negative amortization (when, because of an increase in interest, monthly payments don't pay all of the interest on the loan, thereby increasing the principal amount owed), whereas the FHLMC does not. Those are just some of the differences that have created a difficult "selling job" for the adjustable rate loans.

Four specific mortgage instruments were selected by the Mortgage Roundtable, according to Earnest, "to narrow down the large range of instruments that are confusing all sectors of the mortgage market."

"These instruments," Earnest said, "should provide an opportunity to develop a stable secondary market in adjustable rate mortgages."

By proposing the four adjustable rate plans, the Roundtable hopes to expedite the "whittling down" process that is already in motion, Earnest added.

In all four ARM loans recommended by the Roundtable, the index used to determine rate adjustments is based on the monthly averages of weekly auction rates on 6 month U.S. Treasury bills. That index was selected because it closely matches the current cost of funds to lending institutions.

Six month adjustment periods were selected for two plans; and one year periods for the remaining two plans. Mortgages with six month adjustments, however, have payment caps for three to five years. The lender would receive a shorter period for interest rate adjustment in return for providing the consumer with a longer term fixed payment.

In order to meet regulations by the Comptroller of the Currency for commercial banks, two of the plans limit interest rate adjustments to no more than 2 percent a year. The remaining loans have no maximum interest adjustment, and none of the loans carry a maximum payment adjustment.

Members of the Mortgage Roundtable attending the recent meeting in Washington were: Merrill Butler, past president of NAHB and a home builder from Irvine, Calif.; Philip R. Brinkerhoff, president and chief executive officer of the Federal Home Loan Mortgage Corp.; Carson Cowherd, a Kansas City home builder and vice chairman of NAHB's Mortgage Finance Committee; Douglas W. Hall, vice president of Continental Illinois National Bank & Trust Company of Chicago; Max H. Karl, chairman of MGIC Investment Corp.; Robert Lisle, president of Prudential Real Estate Investment Corp.; Everett Mattson, executive committee chairman of the Lomas & Nettleton Company; Robert Rosen, president of Shearson Realty Group/Shearson Loeb Rhoades Inc.; and Lewis W. Teel, senior vice president of Bank of America.

Others attending the meeting included Frederick J. Napolitano, first vice president of NAHB; James Shimberg, a Tampa, Fla., home builder and chairman of NAHB's Mortgage Finance Committee; Joseph S. Howell, a home builder from Ft. Worth, Tx., and a member of NAHB's Mortgage Finance Committee; Marvin Gilman, a home builder from Wilmington, Del., and a member of NAHB's Mortgage Finance Committee; David Marshall, senior vice president for Computer Power Inc., and Steve Reahm, project manager for adjustable rate mortgages for the Federal Home Loan Mortgage Corp.

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Senator LUGAR. And now, Mr. Waldo?

STATEMENT OF ROBERT L. WALDO, REPRESENTING MORTGAGE INSURANCE COMPANIES OF AMERICA, ACCOMPANIED BY CLAUDE POPE, AMERICAN MORTGAGE INSURANCE CO., RALEIGH, N.C.

Mr. WALDO. Thank you, Senator. I have submitted a prepared statement which I would like to have entered into the record and I would just like to take a few minutes to summarize the statement and perhaps supplement it.

Senator LUGAR. It will be entered in the record in full as will all the statements of the panel, and if you will summarize it we would appreciate it.

Mr. WALDO. Thank you.

I am president of the Mortgage Insurance Companies of America, and I testified before this subcommittee previously on April 21 in support of the administration's recommendation that the ceilings be imposed on the insuring authority of the Federal Housing Administration. We recognize, Senator, the vital role the FHA has played in providing housing in this Nation and we recognize that it will continue to have a vital role to play in providing housing for that segment of the market that simply can't be helped by the private sector.

The biggest problem right now is affordability and, of course, that has to do with interest rates, and we believe that the most crucial thing that has to happen in order to make housing affordable is to get both inflation under control and interest rates under control.

REDIRECTION OF FHA RESOURCES

We thoroughly agree that the FHA's resources should be redirected to those who are not adequately served by the private sector and I guess if we have any concern with S. 1702, it's that it doesn't perhaps limit the effort of the FHA in that respect.

I would like to just refer to a few of the specific titles. Section 101, for example, would serve first-time homebuyers whether or not they could be served by the private sector. In the first three-quarters of 1981, more than 35 percent of the 270,000 mortgages which our companies have insured have involved a 5-percent downpayment. We don't collect specific statistics as to whether or not this is a first-time homebuyer or not, but quite likely it is, because if a person was buying his second home he would have some equity to put into it.

Furthermore, approximately 70 percent of our insured loans have been made to borrowers who are 35 years of age or younger. This is typically the first-time homebuying age. So we believe that we have insured 97,000 mortgages for first-time homebuyers, which is about the equivalent of the 96,000 first-time homebuyers loans that the FHA believes that it has made in the first three-quarters of this year.

With respect to the alternative mortgage instruments and the 5-year balloons, our industry has been insuring all sorts of alternative mortgage instruments since they have been authorized, and I

guess our concern primarily with respect to 5-year balloon mortgages is that if the FHA is to be redirected to those who are least able to cope with economic adversity, they would be hard put, I think, to cope with the uncertainty of what interest rates are going to be when that loan comes due.

With respect to Title V: Manufactured Housing, I would point out that our industry has been insuring loans on manufactured housing where it has been affixed to a site built permanent foundation, and we have been doing this successfully for years. We would observe that it has been the experience of some of our affiliates that in trying to insure loans on these homes where they are not affixed to a foundation and where they have to be consumer-type loans has not been the most prudent method of making those loans or of insuring them.

Finally, we would point out that we recognize the very gravity of attracting capital to housing and this is not, we feel, because housing doesn't offer—or mortgages do not offer—a comparable rate on returns to other forms of investments that investors can make, but primarily it's the inability to get conventional mortgage-backed securities to the marketplace in a way that makes it easy to do and financially attractive to do.

GNMA has been the major source of secondary financing for housing and it's because it's a Government-backed security. The conventional mortgage-backed securities that are being proposed now by both FNMA and Freddie Mac I believe in time will be equally successful as GNMA in attracting capital to housing. However, so long as a GNMA security is available in almost unlimited quantities and without any signal from the administration that this in time will dry up, I think it's going to be very difficult for the conventional mortgage-backed securities to really be developed. We think this is a very important part of the redirection of the FHA and the redirection of GNMA to serving the segment of the market that can't be served by the private sector.

Again, I would be glad to answer any questions that you may have. I'm sorry. I wanted to make one more comment with respect to the inner-city loans.

INNER-CITY LOANS

While we have not in our industry been able to gather statistics from all of our companies as to what's been going on in the inner cities, we know that we have been very effective in working with the neighborhood housing service corporations in plans like the Philadelphia Plan. Since 1978, for example, our industry has insured almost 7,000 mortgages in that Philadelphia Plan. These were in urban areas where the loans averaged $17,500 in 1976 and $22,500 in 1980. Now obviously, these were rehabilitation loans and our experience has been remarkably good in those areas.

Our thrust in the inner cities has been most successful when there's been a concerted effort of community officials, concerned citizens, and the private sector, and we feel that those three elements are necessary to have a successful program and where they are present the program does work.

Senator LUGAR. Thank you very much, Mr. Waldo.

[Complete statement follows:]

STATEMENT OF PRESIDENT ROBERT L. WALDO OF THE MORTGAGE INSURANCE COMPANIES OF AMERICA (MICA), NOVEMBER 19, 1981

Mr. Chairman and Members of the Subcommittee: My name is Robert L. Waldo, I am President of Verex Assurance, Inc., of Madison, Wisconsin, the nation's second largest private mortgage insurer and I am also the current president of the industry's trade association, the Mortgage Insurance Companies of America (MICA)[1]. I appear here today as President of MICA.

On April 21, 1981, I testified before this subcommittee in support of the Administration's recommendation that a $35 billion ceiling be imposed on the insuring authority of the Federal Housing Administration for fiscal year 1982. In that April testimony, I presented the record of the private mortgage insurance industry and the reasons why we believed it was time to initiate a gradual phase-out of that part of the FHA which competes with the fifteen private mortgage insurers for essentially the same market. I will not take the time to repeat the data we furnished at that time, although we commend that testimony to the subcommittee's attention as it demonstrates that the FHA's unsubsidized programs—which constitute at least 80 percent of FHA's total mortgage insurance activity—serve essentially the same market as is served by the private sector. We believe that the FHA's resources should be redirected to those who are not adequately served by the private sector. These have been described by the FHA Commissioner, in a recent public appearance, as those who are truly needy, earning 50 percent or less of the median income, and first time home buyers who cannot be served adequately by the private sector. I will elaborate on that theme in my following discussion of specific parts of S. 1702.

S. 1702 is cited as the "FHA Revitalization Act of 1981," and Title I of the bill would permit adjustable rate mortgages under such terms as the HUD Secretary would prescribe. This authority would be limited to first time home buyers who are defined as those who did not own a dwelling unit within the three years preceding the date of insurance application.

Our basic concern with S. 1702 is that it would point the FHA in the wrong direction, and would have the FHA become more involved, rather than less involved, in areas which the private sector can adequately serve.

An important point to remember is that the FHA does not provide financing. It insures loans that are made by financing institutions. A loan insured under one of the FHA's four unsubsidized programs is not a subsidized loan. True, the interest rate is fixed by administrative fiat, but if the administrative rate is below the market rate, which is most often the case, the loan originator must charge a front-end fee to make up the difference. Under current law, this fee is collected from the seller; but knowledgeable sellers build the fee into the asking price of the property. To the extent that home prices are set to accommodate FHA's home financing, the "comparable" prices of homes sold with conventional financing are affected. Thus, the widespread availability of FHA insurance has contributed to the inflation of housing costs.

A second point to note is that an FHA insured loan has no particular appeal to investors. Standing alone, conventional loans are as attractive to investors as FHA loans. However, investors today aren't buying mortgages, they are buying mortgage backed securities, the most popular of which are GNMA certificates. GNMA certificates, which have the 100 percent full faith and credit backing of the United States, can be issued only against loans which are FHA insured or guaranteed by the Veterans Administration. The private sector is presently developing securities as comparable as possible to GNMA certificates to be issued against pools of conventional mortgages. However, these conventional securities, which we believe will be necessary to provide the funds needed for housing, will never get a chance to develop so long as they are crowded out of the market by securities carrying the full faith and credit of the United States. The additional authority granted to FHA by S. 1702 will make more loans available for GNMA certificate financing, thus further crowding out and inhibiting the conventional loan market. More important, howev-

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[1] The Mortgage Insurance Companies of America is a trade association consisting of 13 domestic private mortgage insurance companies whose insurance in force on Sept. 30, 1981, was $118.8 billion. The national officers of the association are Robert L. Waldo (president, Verex Assurance, Inc.), Madison, Wis., president; Leon T. Kendall (president, Mortgage Guaranty Insurance Corp.), Milwaukee, Wis., vice president; William A. Simpson (president, Republic Mortgage Insurance Co.), Winston-Salem, N.C., secretary; Claude E. Pope (president, American Mortgage Insurance Co.), Raleigh, N.C., treasurer; and John C. Williamson, Washington, D.C., executive vice president.

er, the increased authorizations will more heavily involve the use of federal guarantees in the total housing picture, at the very time the Administration seeks to restrain the government's impact on the credit market.

The question then arises as to whether the government's involvement in unsubsidized home programs serves any segment of the housing market not served by the private sector. We believe that limiting FHA's insurance authority to areas of the market not served by private enterprise is consistent with the stated objective of S. 1702 as set forth by the Chairman in his introductory remarks on October 5 as follows:

"Most home purchases should and can be financed by the private sector. But there will continue to be marginally qualified buyers, young families, and others for whom conventional financing will not be suitable."

Section 101 of S. 1702, however, would serve first time home buyers whether or not they are being served by the private sector. In the first three quarters of 1981, more than 35 percent of the 270,000 mortgages our companies insured involved a 5 percent downpayment, and more than 70 percent of our insured loans were made to borrowers 35 years of age or younger. The 97,000 mortgages with a 5 percent downpayment involved, for the most part, first time home buyers. In all of the four unsubsidized home programs, the FHA insured 145,419 mortgages during these three quarters of 1981. Assuming the validity of the FHA's claim that two-thirds of their programs served first time home buyers, this comes to 96,000 first time home buyers. From the FHA's lender profile statistics it is apparent that a substantial percentage of the FHA's 96,000 first home buyers would have qualified for conventional financing.

We therefore recommended that section 101 be amended to limit its application to first time home buyers who are unable to obtain financing under comparable terms without some form of Federal assistance. We suggest the application of eligibility criteria such as that administered by the Farmers Home Administration limiting assistance to an applicant who is "unable to secure the credit necessary for such housing . . . from other sources upon terms and conditions which he could reasonably be expected to fulfill."

Section 102 of S. 1702 would extend the maximum section 203 limits for 2-, 3-, and 4-family structures by 58 percent to 124 percent above those approved by the Congress in the 1979 Housing Act. This, we believe, is designed to adjust such limits to the increase Congress approved earlier this year for single family homes.

We believe that these provisions point the FHA in the wrong direction. If Federal assistance through 100 percent insurance is necessary for one to obtain home financing, then we believe it would be more appropriate to limit such assistance to lower priced housing. Federal guarantees should be used sparingly and then only to accomplish some compelling social need. We find it difficult to visualize what compelling social need is met by using federal credit to purchase a single family home priced in excess of $100,000 or a four family structure for $240,000. If there is a reservoir of credit in this country that is available only to loans with 100 percent federal guaranty, then an appropriate quid pro quo should be the channeling of this federally guaranteed credit to housing at the lower end of the price spectrum.

Title II of the bill would provide for a 5 year unamortized balloon mortgage under section 203 of the National Housing Act. Because we believe that the FHA should be redirected to assisting those families who are unable to obtain adequate financing in the private sector, we must conclude that balloon financing would impose severe hardship on such families. If it is difficult now for them to qualify for financing, it will be even more difficult in five years should inflation remain at current high levels and interest rates resume their escalation.

While we recognize the present need for authority to be as flexible as possible in developing home financing techniques, we question whether five year balloon loans should be institutionalized as part of the government's insurance programs. The balloon loan was the prevalent form of loan used prior to the depression of the 1930s. Because of the hardships imposed by the liquidity crunch of the 1930s, the practice was all but eliminated with the enactment of the Home Owners Loan Act of 1933. We believe the subject deserves thoughtful attention at this time, particularly in consideration of the FHA's intended constituency—namely, those least able to cope with economic adversity.

As private mortgage insurers, we are concerned with the risks both to home buyers and insurers implicit in balloon financing and I seriously doubt that a private insurer would embrace balloon financing unless there was a guaranty of refinancing at market rates when the mortgage was due at the end of the 5-year period. We respectfully insist that this is not an area for the FHA which should be directed to families of low and moderate income who need assistance from the Federal government.

We have reviewed Titles III and IV of the bill, and offer no comment because of our previous comments regarding the role of the FHA's unsubsidized home mortgage insurance programs.

With respect to Title V, we offer this comment. The experience of some of our affiliates in insuring mobile home loans demonstrates that it is difficult to insure consumer-type loans on mobile homes as chattels. Many of our companies have been successfully insuring loans on manufactured housing and on mobile homes affixed to site-built permanent foundations. To the extent that Title V would accomplish this transformation, it merits support from the Congress.

We view Title VI as an appropriate function for the FHA. It would waive minimum property standards for housing more than 30 years old provided the mortgage proceeds are used for rehabilitation and the property complies with applicable health and safety codes. We view this as a core city program in economically marginal but viable neighborhoods. It is consistent with our views that the FHA's assistance should be directed to the fulfillment of a compelling social need not adequately served by the private sector.

In summary, the FHA, by and of itself, does not make financing available. The FHA 203(b) program was designed as an actuarially sound insurance program, needed in the 30's to revitalize the housing market. Today, the private sector provides that insurance. The private sector and the FHA 203(b) program serve the same young, marginally qualified home buyer. If more marginal credit risks are to be accommodated, they must be served through subsidy or special risk programs and not through programs designed to be actuarially sound. We believe that only with respect to the latter do we find an appropriate rationale for the FHA in future years.

Senator LUGAR. And now, Mr. Hart?

STATEMENT OF JOHN HART, REPRESENTING INDIANA HOMEBUILDERS ASSOCIATION

Mr. HART. Senator Lugar, we were so pleased when you became chairman of the Housing Subcommittee. We formed a task force, and knowing that you were dedicated to a balanced budget, a nonsubsidy approach. Our task force set our first criteria to try to come up with some ideas for housing that had no budgetary impact on the Federal Government.

SUPPLY-SIDE ECONOMICS FOR HOUSING

In fact, although this particular point hasn't been defined for Webster yet, we felt we came up with some supply-side economics for housing.

Basically, the three areas that our task force worked on were the landlease program. We have provided you a table in the presubmission that shows that at any rate level of an FHA loan and where the land is 25 percent of the market value of the property, the landowner by holding a landlease at a below market rate you could save about 200 basis points in the overall loan structure. This 200 basis points on $50,000 will amount to $1,750 less income that will be required on that particular home.

We also address the question of the condominium programs which are not working. In reference to section 234, you heard the FHA Director say, there's only been 2,000 units built in the last 20 years, and I don't know where they were built, maybe in New York in high-rises. First of all, section 234 requires Davis-Bacon. We have enough problems with multifamily and the Davis-Bacon requirement which tends to hold up the wages of the entire construction industry because our subcontractors can't hire a plumber and run him out to a multifamily project one day and then ask him to go back, take lesser pay and go to a single family project the next

day. So Davis-Bacon on multifamily projects has affected single family contractors' labor rates.

Also on section 234, there is a 50-percent requirement on presale and the feeling in the industry was that with presale and redtape to build under the program that was just not workable, so we circumvented it and we used what we called a townhouse on the green concept, section 203(b). We were allowed by FHA to have some form of association—in some cases we even built swimming pools and recreational areas as part of the development, but units qualified only if you have land underneath the unit. This meant you could use a duplex and split it down the middle and sell each side separately as a quasi-condominium or you could use a four-plex or you could use a row townhouse and they would qualify under 203(b), or a single family program. FHA had some MPS's on those units that required construction of party walls between the units to be almost as expensive as separating the units to a detached unit. We went ahead with those programs because of better land use and greater density, side yard, back yard, front yard requirements were minimized.

One of the tables which I provided has just recently been taken from FHA evaluations in the State of Indiana, a one-story detached home—the value on market price—is $34 to $37 a square foot without the lot. A duplex drops off to $29 to $32. A row ranch to $26 to $29, and a two-story row house to $24 to $27 a square foot. That's almost a $10 savings, the price of a detached home in the market price. Reasons are the density and a better use of land.

Also, if you would study a walkup apartment today and take a comparison of what rental FHA multifamily garden apartments have been costing and taking those costs and trying to revise walkups to a market for sale, we think in Indiana, that we could build walkups from $22 to $25 a square foot which would open up the $30,000–$40,000 sales market.

What we are obviously saying, if the walkup apartments could be moved over into 203(b), we wouldn't have Davis-Bacon and we would have a product in a marketplace that's void today otherwise. The $30,000 to $40,000 range of prices, which is a much more modest step for the first-time home buyer coming out of an apartment to go from a $250 to $300 a month rent into a $30,000-$40,000 product than it is to move into a $45,000 or $50,000 home, which is the only other optional product out there today in the marketplace.

We believe—and I continually try to sell young people on the fact that you can't live in a 10 percent or higher inflationary market with such unsettled conditions and throw away rent receipts every month. As a renter you are going to fall behind quickly economically. In fact, poor people are not benefiting by getting rental subsidies and living in rental apartments. If we truly want those people to progress in inflationary times we should give them the benefits of an equity buildup and the appreciation that inflation gives through ownership. We should design programs for poor, and moderate income families and all to encourage ownership positions.

In the area of FHA, if I might diverse for just a moment, FHA has been an innovator since its beginning. It is the one, if I can use the term, that keep the private sector honest, competitive. We

don't have any major competition out there in the marketplace today. I think Paul explained that today current rates are 17.5 and 18.5 on local mortgages. They offer in some cases a 5-year balloon mortgage with 3-point discounts up front and they're willing occasionally to knock 100 basis points off the rate.

S. & L. industry today is in real serious trouble pricing their mortgage money on the basis of the highest cost of any source of their money. Years ago they used to price money on the basis of their average cost of their portfolio. I understand their predicament because they can't have 15 percent or 16 percent 30-month certificates out there in the market with their normal markup of 200 basis points, and loan below current rates. They are going to hold at 17- or 18-percent rate because they're still paying interest on 15- and 16-percent CD's.

This isn't going to let up for 1½ or 2 years because only as recently as 3 months ago they were still paying 15.5 percent and 16 percent on 30-month CD's, in fact as of today I think it's only down around the 14 percent range.

BALLOON OR ROLLOVER MORTGAGES

Short-term rates have dropped. Long-term rates still lack stability. Who knows what's going to happen in 30 years. Will Reaganomics work, or what's going to happen? Leaders will lend short and make investment judgment on mortgages and such only on a short-term basis. This is the reason our task force recommended to you that FHA innovate a 5-year either balloon or rollover mortgage. I don't agree with Phil Winn on the fact that FHA shouldn't put someone in a position of a balloon mortgage although he would accept a rollover type mortgage. I want to give you a little history on this.

The typical mortgage, even though it's 30 year in term, still pays out in 11 years, and this is dropping. In fact, I think if the people from MIT would look at it a little closer, I think that's edging down below 10 today. For yield purposes, a lender used an 11-year payout. Using a 11-year payoff, it takes eight discount points up front to provide a 1 percent yield on an 11-year term mortgage.

On a 5-year mortgage we can buy down a 1 percent or 100 basis points on a mortgage with 3⅓ discount points or we can buy down 3 percentage points or 300 basis points for 10 points only slightly more than the 8 points for reduction of 100 basis points on the current mortgage market. Now each time you buy down 100 basis points you're reducing, a $40,000 mortgage by $400 a year or $500 a year on a $50,000 mortgage, and you're then requiring a $1,500 or $1,750 less income to qualify for the same mortgage.

Under the 5-year term that we propose, which could either be a—balloon or rollover. I would accept a rollover, providing it has a maximum term of 10 years, the 5-year period would allow us to buy the rate down comparable to a 5-year mortgage. The investor would have a purchase-down rate for 5 years and then the next 5 years they would have a market rate which would be the then FHA current market rate. This would not give us as deep a discount as a 5-year balloon the difference between short- and long-

term bonds is another 150 basis points that we could save with a balloon type mortgage.

Looking at the Indiana housing bond issue, 25-year bonds. We don't know at this time whether they're going to be salable in the marketplace. In Connecticut a sale was held yesterday and the market was down again and the rate up as required by investors because of the long term. We have asked our private insurers to come up with some form of an insured takeout so maybe our bonds could be reduced to a 10-year balloon, and then have an insurer or the servicing lender provide a loan at market rate after that 10-year period. This would allow us to get the tax-exempt bonds to the user at a lower rate for the first 10 years. We haven't accomplished that yet, but we're working on it.

You gave credit to FHA for innovating graduated payment mortgages. I recommended that before Senator Proxmire's committee in 1974. It took us until 1978 to get the graduated payment mortgage through. It wasn't an FHA innovation. Their innovations have been in reducing the equity requirement on a mortgage and their innovations have been in extending terms, the terms for homes were 5-year terms and 3-year terms with 50 percent down. When FHA came in existence, it went from a 10- to a 15- to 25- to 30- or 35- and 40-year mortgage. Those are all innovations. We need FHA to stay in place for multifamily, and for the inner city where the risks must be spread. Senator Lugar, no one is more familiar with the inner cities than you are, that makes it twice as much benefit to the United States to have somebody of your background as chairman, someone who understands the problems of the urban areas. You gained your knowledge as mayor of Indianapolis—I believe that our recommendations outlined today and recommendations that you have included in your bill S. 1702 will give us the tools to not only develop housing affordability again, but also put us in a position of doing some redevelopment in the inner city. And with that, I will conclude.

Senator LUGAR. Thank you very much, and I appreciate your testimony here today.

[Complete statement follows:]

STATEMENT OF JOHN C. HART, CHAIRMAN, INDIANA HOUSING TASK FORCE [1]

Subject: Senate bill S. 1702—FHA Revitalization Act.

DEAR SENATOR: We believe very strongly that a federal balanced, budget at one is imperative. We believe the Reagan administration's budget reduction and tax reductions were exceptionally strong moves in the right direction. We do not like the strict federal monetary policy (high interest rates) but realize that it is part of the overall strategy.

We want you to realize that our industry, although severely crippled by many of these actions, is still supportive of them. Our committee further agrees that reduced regulations and less federalism are appropriate goals or objectives.

Given certain tools, Indiana can meet its own housing requirements with minimal federal support. We believe very strongly that FHA should be retained primarily as a federal housing insurance program. We believe FHA should be innovating new ideas to keep housing alive during these critical economic periods.

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[1] Indiana housing task force committee members: John C. Hart, Chairman, Dean McFarland, Charlie Pechette, Steve Jenn, Dick Crosser, Frank Jackson, Dick Inman, Jim White, Carl Pruesse, Dick Gibbs, Dick Nye, Mike Hannigan, and Dick Tyson.

Our committee doesn't believe that housing should roll over and play dead in today's economy. Supply-side economics for housing can create new jobs, new tax base and require less federal handouts.

We have attempted in the following papers, to show you some innovative ideas of how to revive housing and the overall economy.

PROPOSAL—FHA 203B SHORT-TERM MORTGAGE PROGRAM I

Whenever the FHA 203B market rate is required to be 10 percent or more, inflation pressures are usually at fault. The inflation pressures create havoc in the residential mortgage funds markets, because lenders borrow short (six-month, thirty-month, four year, etc.) and lend long (twenty-five years, thirty years). The greater the fear of the unknowns of continuing inflation, the more the market builds inflation expectations into the rates. Today is a true example of this condition; although actual inflation is 9 percent and with confidence should provide 12 percent or 13 percent long-term rates, the marketplace is asking 16½ percent to 17½ percent for long-term rates.

During these periods of instability, FHA should offer five-year (balloon) mortgages with 30-year amortization. GNMA could package this short-term paper for the secondary markets. It is estimated, the short-term five year notes would allow 100 to 150 basis points reduction below current long-term FHA rates. Example: current FHA rate of 15.5 percent would be 14.0 percent.

The typical mortgage, although carrying a thirty-year term, pays out in less than eleven years. If a seller wanted to discount (buy down) a rate on present thirty-year paper, it would cost eight points to discount 100 basis points. With a five-year FHA (balloon), the seller could buy the rate down 100 basis points for 3.33 points, or 300 basis points for 10.0 points.

For years, the Federal government, by using FHA insurance, has given home ownership opportunities to millions of Americans.

Borrower equity (down payment) requirements and long-term mortgages (15, 20, 25, 30) years were FHA innovations. Today, FHA is following the market, not leading it.

There is no sensible reason for the housing industry today to be at a virtual stand-still. FHA must adjust to market conditions, innovate, lead the market in new directions.

A five-year FHA (balloon) instrument would get us through this crisis and future down cycles. The consumer would benefit by the lower rates. Housing would again become affordable to many families.

Example Reductions

Market rate:	*Percent*
30-year	15.5
5-year	14.0
10 point buy down[1]	11.0

[1] A combination of a 5-year mortgage and buy down would compete head on with tax-exempt housing bond user rates.

The above proposal does not have any Federal Appropriation requirement. In fact, implementation of the program will increase employment and local state and federal tax revenue, while reducing employment, welfare, and food stamps.

PROPOSAL—FHA 203B FOR-SALE CONDO PROGRAM II

A recent Indiana Housing Appraisal Study confirmed the following:

The finished lot tends to equal 25 percent of the sales price.

The one-story ranch home with garage and without lot markets from $34 to $37 per square foot.

The duplex-ranch with garage and without lot markets from $29 to $32 per square foot.

Then ranch-row house with no garage and without lot markets from $26 to $29 per square foot.

The two-story row house without garage and without lot markets from $24 to $27 per square foot.

It becomes obvious that the greater density in land use and attaching units, makes the end product more economical.

For many years, builders have allowed Section 203B FHA to serve their condo programs. FHA 203B allows financing on 1-4 family units. This section of the housing act allowed individual deed-outs of single detached, duplex, four-plex and

row housing as long as lots were platted and each had defined land as platted. The multifamily type units deeded separately, in fact, became condo-type units. Usually, a neighborhood association was formed for exterior maintanance of common areas and/for recreational facilities. In Table C, you can see the major savings available to consumers by this type of building and individual financing.

At the same time, the FHA Section 234 condo program did not work. This program required Davis-Bacon prevailing wages as in other multifamily (FHA) sections.

It also required 50 percent pre-sales before FHA would insure the project. Since the 1960's, very few housing markets could sustain the pre-sale requirement and allow any major productive capability.

The program has been determined to be a non-feasible section of FHA.

Condo convertors were the first to realize the garden apartment cost factor relationship as to converting to ownership.

There are literally thousands of rental apartments being modernized and converted to sales-condos because of a vacuum in the $25,000 to $40,000 price range.

This massive conversion could be contained and the rental stock preserved if there was a viable alternative.

We propose allowing Section 203B to be expanded from 1-4 units to 1-9 units. We believe flats (garden) apartments should be allowed to qualify for insurance with special horizontal platting.

FHA should issue up to eighteen advance conditional commitments for this type of condo project. These conditional commitments would be 70 percent to value and would be converted to up to 95 percent with a firm approved buyer. Should the units not be sold in six months, a 70 percent commitment would be closed in a builder's name (builders-operative type) and the unit could be rented.

The builder would be required to sell the unit within five years. If a builder has over five unsold (builder-operative) units upon completion, FHA could impose future pre-sale requirements on additional buildings.

The ability to build garden-type apartments with a feasible (FHA 203B) financing will fill a void in the current market in the $25,000 to $40,000 range and would offer today's first-time home buyers a softer step into the ownership market. Retirees, the fastest growing sector of our population, could find this market more attractive than rentals in an inflationary environment, while locked into fixed incomes.

Once again, this proposed program has no federal budget (appropriations) needs and will have positive results on our economy.

THE LEASE-FINANCE OPTION PROGRAM III

Today the finished lot is 25 percent of the sales price of a typical new home. We have prepared a schedule showing how owner financing or leasing of land could reduce finance costs. Typically a land lease would reduce the market financing cost by nearly 200 basis points annually.

Purchasers should be given the option to buy based on 25 percent of appraised value at each option period, or the related percentage value of the original sale, or on a fixed cap-rate determined in advance.

AFFORDABILITY TABLE—MAXIMUM MORTGAGE BY INCOME AND RATE

Mortgage market rate (percent)	Ratio mortgage to income	Maximum mortgage						
		$16,000	$18,000	$20,000	$22,000	$24,000	$26,000	$28,000
17	1.48	$23,680	$26,640	$29,600	$32,560	$35,520	$38,480	$41,440
16	1.56	24,960	28,080	31,200	34,320	37,440	40,560	43,680
15	1.65	26,400	29,700	33,000	36,300	39,600	42,900	46,200
14	1.75	28,000	31,500	35,000	38,500	42,000	45,500	49,000
13	1.85	29,600	33,300	37,000	40,700	44,400	48,100	51,800
12	1.97	31,520	35,460	39,400	43,340	47,280	51,220	55,160
11	2.10	33,600	37,800	42,000	46,200	50,400	54,600	58,800
10	2.23	35,680	40,140	44,600	49,060	53,520	57,980	62,440
9	2.35	37,600	42,300	47,000	51,700	56,400	61,100	65,800
8	2.48	39,680	44,640	49,600	54,560	59,520	64,480	69,440

Market rate 30 yr (percent)	Users rate probable tax exempt bond, 30 yr	Tax-exempt bond, 10 yr	FHA, 5 yr	FHA [1]
17	13.5	12.0	15.5	[2] 12.5
16	13.0	11.5	14.5	11.5
15	12.0	10.0	13.5	10.5
14	11.0	9.0	12.5	9.5
13	10.0	8.0	11.5	8.5
12	9.0	7.0	10.5	7.5
11	8.0	6.0	9.5	6.5
10	7.0	5.0	8.0	5.0

[1] 3-percent buy down, 1 percent equals 3⅛ points (high)
[2] Mortgage—10 points

	Low	High
State median family (4)	$20,000	$24,000
80 percent median	16,000	19,200
125 percent median	25,000	30,000

INDIANA HOUSING PRICE SURVEY

	Cost: 34–37; with garage; ranch with lot price	Cost: 29–32; duplex with garage; ranch with lot price	Cost: 26–29; ranch; row with lot price	Cost: 24–27; 2-story; row with lot price	Square feet
High	$34,447	$29,792	$26,999	$25,137	700
Low	31,654	26,999	24,206	22,344	
High	39,368	34,048	30,856	28,728	800
Low	36,176	30,856	27,664	25,536	
High	44,289	38,304	34,713	32,319	900
Low	40,698	34,718	31,122	28,728	
High	49,210	42,560	38,570	35,910	1,000
Low	45,220	33,570	34,580	31,920	
High	54,131	46,816	42,427	39,501	1,100
Low	49,742	42,427	38,038	35,112	
High	59,052	51,072	46,284	43,092	1,200
Low	54,264	46,284	41,496	38,304	
High	63,973	55,328	50,141	46,633	1,300
Low	58,786	50,141	44,954	41,496	
High	68,894	59,584	53,998	50,274	1,400
Low	63,308	53,998	43,412	44,638	
High	73,815	63,840	57,855	53,865	1,500
Low	67,830	57,855	51,870	47,880	
High	78,736	68,096	61,712	57,456	1,600
Low	72,352	61,712	55,328	51,072	

INDIANA HOUSING BONDS

[Amounts in dollars]

Mortgage	A		B		Monthly Payment C	
	Annual debt service 12 percent	Required income	Annual debt service 13 percent	Required income	A	B
25,000	3,623	12,680	3,855	13,493	302	321
27,500	3,985	13,948	4,241	14,842	332	353
30,000	4,347	15,215	4,626	16,191	354	386
32,500	4,709	16,482	5,012	17,540	392	418
35,000	5,072	17,752	5,397	18,890	423	450

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INDIANA HOUSING BONDS—Continued

[Amounts in dollars]

Mortgage	A		B		Monthly Payment C	
	Annual debt service 12 percent	Required income	Annual debt service 13 percent	Required income	A	B
37,500	5,434	19,019	5,783	20,239	453	478
40,000	5,796	20,286	6,168	21,588	483	514
42,500	6,158	21,553	6,554	22,937	513	546
45,000	6,521	22,823	6,939	24,287	543	578
47,500	6,883	24,091	7,325	25,636	574	610
50,000	7,245	25,358	7,710	26,985	604	643
52,500	7,607	26,625	8,096	28,334	634	675
55,000	7,970	27,895	8,481	29,684	664	707
57,500	8,332	29,162	8,867	31,033	694	739
60,000	8,694	30,429	9,252	32,282	725	771

	A (percent)	B (percent)
Interest rate	12.00	13.00
Constant	12.34	13.27
Taxes	1.25	1.25
Insurance	.40	.40
Mortgage insurance	.50	.50
Factor	14.49	15.42

[income rates 3.5 to 1]

Mortgage	Required income			
	14 percent	15 percent	16 percent	17 percent
$30,000	$17,189	$18,186	$19,205	$20,234
$35,000	20,053	21,217	22,405	23,606
$40,000	22,918	24,248	25,606	26,978
$50,000	28,648	30,310	32,008	33,723
Factor	16.37	17.32	18.29	19.27

LAND LEASE FORMULA

[Amounts in dollars]

Total sales price, 100 percent	Lot, 25 percent	Improvements, 75 percent	5 percent down	95 percent typical mortgage	Mortgage with/lease
30,000	7,500	22,500	1,500	28,500	21,000
35,000	8,750	26,250	1,750	33,250	24,500
40,000	10,000	30,000	2,000	38,000	28,000
45,000	11,250	33,750	2,250	42,750	31,500
50,000	12,500	37,500	2,500	47,500	35,000
55,000	13,750	41,250	2,750	52,250	38,500
60,000	15,000	45,000	3,000	47,000	42,000

FORMULA

[In percent]

Current rate	Mortgage, 70 percent	Cash, 5 percent	Leased land, 25 percent	Net effective rate
17	17	0	12	14.90
16	16	0	11	13.95
15	15	0	10	13.00
14	14	0	9	12.05
13	13	0	8	11.10
12	12	0	7	10.15
11	11	0	6	9.20
10	10	0	5	8.25

Senator LUGAR. Now I'd like to call upon Mr. Willard Gourley, Jr., representing the Mortgage Bankers Association of America.

STATEMENT OF WILLARD GOURLEY, JR., REPRESENTING THE MORTGAGE BANKERS ASSOCIATION OF AMERICA, ACCOMPANIED BY BURTON WOOD, LEGISLATIVE COUNSEL, AND SHARON CANAVAN, ASSOCIATE LEGISLATIVE COUNSEL

Mr. GOURLEY. Thank you, Mr. Chairman.

My name is Willard Gourley, and I'm president of the First Atlantic Corp., a mortgage banking company located in Charlotte, N.C., and I also serve as chairman of the legislative committee of the Mortgage Bankers Association of America. Mortgage bankers are a principal source of mortgage credit. In recent years, we have provided between 20 and 25 percent of single-family mortgage originations, and have originated over 80 percent of FHA mortgages.

We appreciate the opportunity to appear before you today and express our views on S. 1702, the FHA Revitalization Act of 1981. While MBA supports the innovative thrust of the bill, we want to stress that Congress should not permit the Federal Housing Administration to abandon its traditional role as the mortgage insurer of fixed-rate, long-term loans. This role should continue even as the FHA broadens its horizons to include innovative, creative financing techniques that should expand affordable mortgage finance options for moderate- and middle-income homebuyers.

MBA would also like to emphasize that in order for these proposed alternative mortgage programs to work, access to the secondary market, through the GNMA mortgage-backed-security program, must be assured in order to broaden capital sources, and to foster the widest possible lender and investor acceptance of the programs.

RESTRICT OPERATIONS OF GNMA-MBS GUARANTY PROGRAMS

MBA is alarmed at the administration's November 5 announcement that it will restrict the operations of the self-supporting GNMA-MBS guaranty program to $48 billion for fiscal year 1982. Restriction of this program by administrative fiat, in blatant disregard of the $68 billion ceiling established by Congress, threatens to disrupt the mortgage market should the ceilings be reached. Should interest rates abate, this move could dampen the housing recovery.

If the GNMA-MBS ceiling is reached, lenders will curtail origination of FHA and VA mortgages, over 70 percent of which are ultimately placed in GNMA-MBS pools. MBA feels that the administration's move to restrict the GNMA-MBS guaranty program is an ill-timed one. Until a conventional MBS is developed and successfully operating, any push to restrict the GNMA-MBS program will have a devastating impact on primary mortgage originations for lack of a readily accessible secondary market.

MBA supports the two major proposals of S. 1702, which would authorize an FHA-insured 5-year mortgage paired with a 5-year GNMA security, as well as an FHA-insured adjustable rate mortgage. MBA suggests that the proposal be amended to provide for up to a 10-year term to allow more flexibility. MBA also suggests that in order to make these programs feasible nationwide, it will be necessary to include a preemption of State laws, regulations, or court cases that restrict or prohibit adjustable rate mortgages, because MBA's research indicates that problems exist in as many as 23 States. There is precedent for such an action in the preemption enacted in 1977 when Congress created the section 245 graduated payment mortgage program.

MBA strongly opposes restricting experimental insurance authority to first-time homebuyers. FHA has always served moderate- and middle-income families purchasing homes in the median price range, and we feel it is inappropriate to disregard the needs of these homebuyers. While the first-time homebuyer is certainly experiencing difficulty in gaining entry to the market, these proposed experimental financing techniques, especially the ARM with its potential payment increases, may be least suited to the first-time homebuyer, who may be stretching a budget to afford a home at all. Rather, moderate- and middle-income families who are current homeowners and have established careers and savings plans may be better candidates for ARM's and other innovative financing techniques. MBA believes that the thrust of the legislation should be to provide financing options that will enhance affordability for all Americans, rather than restricting those alternatives to certain groups.

To encourage investment in small, multifamily dwellings, MBA supports the proposed increases of the maximum mortgage amounts for two- to four-family units insured under section 203(b)(2). We believe that this will have a positive effect on the multifamily rental market. However, MBA encourages this subcommittee to consider using a sliding scale, similar to that currently provided under the single-family program in high-cost areas, to provide greater flexibility and more accurately reflect local market conditions and prices.

Condominiums are often one of the few remaining affordable housing options open to many homebuyers, and, therefore, MBA supports sections 301 through 303, which ease requirements on condominium financing. MBA also supports the liberalized provisions for homes built on leased land and for manufactured housing, because of their potential for enhancing affordable housing alternatives. Although MBA supports the thrust of section 601, which liberalizes standards for insurance on "shells" suitable for rehabili-

tation, MBA suggests that local standards should apply to all 203(k) loans, not just those for "shells" that are 30 years or older.

CONSIDERATION OF ADDITIONAL PROVISIONS

In addition to these comments on the proposed legislation, MBA urges favorable consideration of the following additional provisions. Removing the interest rate ceiling on FHA-insured mortgage loans would help to reduce the inflationary pressures on the costs of homeownership for millions of Americans. Sellers necessarily increase the sales price of homes sold to FHA-insured buyers to recapture the discount points that are charged by the lenders to make the yield of an FHA mortgage conform to market prices. In a speech at MBA's recent annual convention, we were pleased to hear from HUD Secretary Samuel Pierce that he supported a free FHA interest rate. MBA urges this subcommittee to act favorably on this request so that both the primary and secondary markets can function without the restraints that currently require compensating behavior and impose distortions in price and affordability.

MBA also urges the inclusion of a provision that would permit lenders to insert a due-on-sale clause in FHA-insured mortgages. To compensate for the lengthier average term for FHA-insured mortgages, because of the ready assumability feature, the market demands a premium in the form of a higher interest rate. Therefore, we urge this subcommittee to authorize due-on-sale clauses in FHA mortgages, so that homebuyers can choose among financing alternatives that are best suited to their incomes and situations.

In closing, I would like to thank the subcommittee for this opportunity to appear and express our views. I would also like to thank you, Senator Lugar, for your foresight in introducing S. 1702 with its innovative solutions to reinforce FHA's role as a creative leading edge in the market. However, I would like to remind this subcommittee that it is equally important not to foresake FHA's traditional role as the insurer of the fixed-rate, long-term mortgage which FHA pioneered. As lenders turn increasingly toward creative financing techniques in order to insulate themselves from inflation and volatile interest rates, FHA-insured mortgages with their ready access to the capital markets via the GNMA-MBS instrument may become the only source of fixed-rate, long-term mortgage finance in the future. Therefore, both FHA and GNMA should remain strong and viable, in order to continue to play a valuable social role in preserving financing alternatives for all homebuyers.

[Complete statement follows:]

STATEMENT OF WILLARD GOURLEY, JR., PRESIDENT, FIRST ATLANTIC CORP., CHARLOTTE, N.C.

Mr. Chairman and Members of the Subcommittee, my name is Willard Gourley, Jr. I am president of the First Atlantic Corporation, located in Charlotte, North Carolina. I serve as Chairman of the Legislative Committee of the Mortgage Bankers Associations of America.[1] Accompanying me are Burton Wood, MBA's Legislative Counsel, and Sharon Canavan, Associate Legislative Counsel.

[1] The Morgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership is comprised of mortgage originators, mortgage investors, and a variety of industry related firms. Morgage banking firms,

I am pleased to appear before you today to discuss various aspects of S 1702, the "FHA Revitalization Act of 1981," which contains a number of innovative approaches to mortgage finance. MBA supports this legislation as an important step to address affordability problems in today's high housing cost environment. However, MBA would also like to stress that the Federal Housing Administration (FHA) has a traditional, as well as an innovative, role to play in the future. We would like to express our concern that experimental approaches to broaden the scope of the FHA programs should not be undertaken at the expense of the time-tested programs, such as the Section 203(b) single-family insured loan program, which has proven to be the FHA mainstay over nearly half a century.

Innovations in mortgage origination programs also need to be matched with creative, new approaches to providing secondary market financing in order to foster the widest possible investor acceptance and to broaden capital sources for mortgage finance. The creation of the Government National Mortgage Association (GNMA) Morgage-Backed Security (MBS) revolutionized mortgage finance by providing highly liquid, securitized instrument, which attracted traditional and non-traditional investors alike. This instrument has served to stabilize the mortgage finance market throughout economic cycles, as well as to create a truly nationwide secondary market, which transfers mortgage funds to credit short areas. The standardized format offered by the GNMA-MBS spurred investor interest in mortgage and has attracted addtional capital for mortgage credit. The GNMA-MBS program is now indispensible to proper functioning of the FHA mortgage insurance and Veterans Administration home loan guaranty programs, because approximately three-fourths of those loans are placed in GNMA-MBS pools. Also, as thrift institutions are decreasing their level of activity as portfolio lenders, the secondary mortgage market will continue to increase in importance over the next decade. Any revisions to FHA's mortgage programs, therefore, must be tied to, and recognize the importance of secondary market acceptance.

We would also like to comment upon several issues directly related to the continued, vigorous, place of FHA in the mortgage marketplace, including the preemption of state laws that could restrict or prohibit the experimental financing programs provided for in S 1702; the failure to include "due-on-sale" clauses in FHA mortgages; and a proposal to free the FHA interest rate to respond to market forces.

ECONOMIC OUTLOOK

The slow monetary growth philosophy of the Federal Reserve Board is a major cause of the depressed state of the housing industry. High financing costs for home builders and potential buyers should keep 1981 housing starts below 1980 levels, perhaps as low as 1.1 million total starts, the lowest volume in at least 20 years. Of this number, approximately 300,000 will be multifamily starts, mostly condominiums. New residential construction in 1982 will be only slightly better, with starts for the year at between 1.3 and 1.5 million units. Between 300,000 to 400,000 of the 1982 starts will be multi-family, again predominantly condominiums. In the resale market, the problems are even more apparent. September existing home sales were at a 2.07 million unit seasonally adjusted annual rate, down 37 percent from last year's depressed sales and almost 50 percent below the levels of 1980. New home sales in September at 312,000 were at their lowest seasonally adjusted annual rate on record since the government began publishing these statistics.

Clearly, the low level of housing construction of the past two years has been a disaster for the industry. But it also represents a disaster for the consumer. Most estimates of population and household formation rates envision the decade of the Eighties as one of continued increasing housing demand. While the general population will increase by 21 million people in the next decade, the population of the prime first-time home buying group, those between 25 and 34 years, will grow by nine million persons by 1990. This is a level three times faster than overall population growth. Many analysts foresee a demand in excess of 2.0 million housing starts per year for the next decade. Clearly, 1981's 1.1 million starts will be far below the equilibrium level. Even more importantly, however, 1982's projected 1.3–1.5 million starts will also fall far short of expected demand. This fact is even more apparent when a comparison is made with the starts levels of the last half of the 1970s, when demand was also high.

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which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include: mortgage banking companies, mortgage insurance companies, life insurance companies, commercial banks, mutual savings banks, savings and loan associations, pension funds, mortgage brokers, title companies, State housing agencies, investment bankers, and real estate investment trusts.

Private Housing Starts (seasonally adjusted annual rate)

Year:	
1976	1,537,000
1977	1,987,000
1978	2,020,000
1979	1,745,000
1980	1,292,000

Source: Department of Commerce, Bureau of the Census.

Some of the shortfall in supply will be made up in part with conversion of commercial properties into residential use. However, the shortage of housing in the face of strong potential demand will cause a significant increase in "doubling up," an increase in the upward spiral of home prices, and continued conversion of rental units to satisfy ownership demands.

The most important issue of housing policy during the next twelve months and, indeed, for the rest of the decade will be the question of the affordability of housing. The current high interest rates have focused new concern on a problem that has been getting worse for several years. The best measures of actual housing affordability indicate that until very recently, more households have been able to afford to purchase housing than was first estimated. However, the number of people who fall into this category has been declining and mortgage rates far above the historical average are exacerbating the problem. During the first quarter of 1981, the median price of a new one-family home sold was approximately $67,000. Assuming a normal downpayment of about 10 percent, the outstanding principal balance of a standard mortgage would exceed $60,000. With a level payment 30-year mortgage bearing a contract rate of 14 percent (the prevailing conventional commitment rate only one year ago), some 25 percent of American families could have afforded to buy that home. At 16 percent, only a little over 18 percent of those families could afford it. And at 18 percent motage rates, a level we have reached and even exceeded in some areas, the number of families that can afford this median price home falls to about 15 percent. Unable to qualify buyers for loans and again caught in a cyclical crunch, the housing industry is moribund.

One major weapon against the affordability problem obviously is lower mortgage interest rates. At this time, a reasonable level of mortgage interest rates to expect by the end of 1981 would be in the range of 15 to 16 percent. A mortgage interest rate of 14 to 15 percent is likely by June of 1982, depending upon several factors. First, the Administration's program, with its emphasis on tax cuts and investment incentives, can be expected to generate additional savings. Also, the classic cyclical pattern of housing credit should itself help to reduce rates by reducing demand for credit. Under this scenario, the current prohibitive cost of mortgage credit should cause demand to slacken until rates begin to decline. This has already begun, but will become most obvious by the second quarter of 1982. Other influences that will aid in reducing mortgage interest rates over the next eight to twelve months include declining inflationary pressures that will result in less of an inflation premium being demanded by long-term investors, and, if Congress passes additional spending cuts, a smaller deficit. This, in turn, will reduce the Federal presence in the credit market and thereby lower the demand for credit, leading to lower interest rates generally.

FHA and GNMA "credit budget" limitations

Until fiscal year 1981 the non-subsidized, actuarially sound, user-fee supported FHA-insured programs and the GNMA-MBS guaranty program operated as demand programs. For the first time, in fiscal year 1981, and in the fiscal year 1982 budget and appropriations measures (H. Con. Res. 115 and HR 4034, respectively), limitations have been imposed on the FHA insurance functions and the GNMA-MBS guaranty program. Furthermore, on November 5, the Administration announced that despite the higher limits agreed upon by Congress, it would administratively restrict the GNMA-MBS to a level of $48 billion in gross commitments for fiscal year 1982, more than $20 billion lower than the Congressionally approved limits, although it would not reduce the levels agreed upon by Congress for the FHA programs.

In the Administration's press briefing conducted after the November 5 announcement of the Administration's cuts in loan guaranty programs, Lawrence A. Kudlow, Assistant Director for Economic Policy at the Office of Mangement and Budget (OMB), claimed that the cuts in loan guaranty programs would "Provide the financial market equivalent of a $20 billion reduction in budget outlays—since loan guarantees are typically converted into direct spending not recorded as part of the

official budget." At least insofar as the GNMA-MBS program is concerned, which is bearing the brunt of three-fourths of the Administration's proposed reductions, this is simply not the case.

The GNMA-MBS program relies completely on private investment sources. Although it is a guaranty program, in the 13 years of its existence, its fee income has always offset its expenses. It has not cost the government a single penny. Additionally, it is a secondary guaranty program. Therefore, a reduction in the program's commitment ceilings would not result in a decrease in overall credit demand, unless, and only to the extent, that the $48 billion GNMA commitment ceiling restricts guaranty loan program activity in the underlying primary programs—the FHA insurance and VA, guaranty programs, which the Administration claims not to be cutting. Finally, FHA loans and GNMA-MBS guaranties are not converted into direct spending, but, rather, are covered entirely by private investment.

MBA views this administrative limitation of the GNMA-MBS program as a backdoor approach to restricting not only the current FHA programs, but also the Veterans Administration (VA) guaranty program, which is an entitlement program. Over 80 percent of single-family FHA loans and over 70 percent of single-family VA loans have been placed in GNMA-MBS pools, on average over the past five years. Should the GNMA-MBS activity ceiling be approached, as it very well could be as interest rates abate in the near term future, lenders originating FHA-insured and VA guaranteed loans might very well discontinue originations for lack of a currently available or future market in the GNMA-MBS program.

Any initiative, therefore, to expand the scope of FHA's programs must take into account the accessibility of financing if the underlying programs are to be a success. Any threat that GNMA-MBS placements would be unavailable poses the probability that these new FHA proposals, even if passed, would not receive a fair trial because of a lack of secondary market access.

PROVISIONS OF S. 1702

Experimental insurance authority

Section 101 of S. 1702 authorizes the Secretary of the Department of Housing and Urban Development (HUD) to develop experimental mortgage insurance programs, and in particular, an adjustable rate mortgage (ARM) program. MBA supports the development of an FHA-insured ARM program, because it will help move the ARM market toward standardization, which is so crucial to the efficient operation of the nationwide secondary market.

MBA supports the provision of broad flexible authority contained in Section 101 which places responsibility to provide for disclosure, and interest rate index and guaranteed refinancing within the jurisdiction of the HUD Secretary. Sufficient authority to regulate consumer safeguards is accorded to the HUD Secretary under proposed Section 101. Because innovative financing techniques, such as ARMs, have not been widely marketed, it will be necessary to fine-tune ARMs, as well as other experimental financing programs that are developed, in order to optimize both consumer provisions and lender/investor market acceptance, as well as to respond to changing market conditions. Therefore, the flexibility of response will be important to the development of viable new programs.

The development of any experimental programs must include access to the GNMA-MBS program. Thus, authority to utilize the GNMA-MBS alternative should be incorporated in the experimental insurance authority, identical to that provided under Section 202 relating to the authorization for five year mortgages.

MBA has a major concern with the development of experimental mortgage programs—that is, their possible impact on the solvency of the Mutual Mortgage Insurance Fund (MMIF). (See Exhibit I). Because the creative financing techniques that are being explored are quite new, there is very little experience upon which to base default projections in order to determine the actuarial features of the program.

While the Section 245 Graduated Payment Mortgage (GPM) program was placed under the MMIF, MBA was not as concerned about possible erosion of the financial soundness of the MMIF, because the payments under the Section 245 program are readily discernible to a potential borrower, and rise slowly to a predetermined level. The ARM plan, proposed in Section 101, would not carry this same degree of certainty, because payments could fluctuate with market interest rates, which are unknown. Even if interest rate "caps" are placed on the program, a borrower would still be uncertain about the potential rate of increase, and might be unable to keep pace with unanticipated interest rate increases. Also, many ARM programs entail negative amortization, which adds another element of risk.

Therefore, MBA suggests that these programs be placed in a separate insurance fund, or under the aegis of either the Special Risk or General Insurance Funds (See

Exhibit I) currently in place, so as not to undermine the actuarially sound status of the MMIF.

Preemption of State prohibitions or restrictions on ARMs

Because state laws, regulations, or court cases restrict or prohibit certain aspects of ARMs in as many as 23 states, MBA urges the inclusion of legislative language that would prempt such restrictions or prohibitions, because their impact would ultimately diminish the broad experimental authority envisioned by this legislation. In order for any experimental mortgage programs to receive an unbiased test and gain lender acceptance, there must be nationwide standardization of the program. Additionally, there is precedent for such a preemption in the action taken in the 1977 housing act, Public Law 95-128, where the Congress created the GPM and overrode state statutes that would have restricted origination of GPMs. Suggested legislative language is included in Exhibit II.

First time home buyer

MBA strongly opposes the provision in Section 247 (c) that restricts experimental insurance authority to a buyer who has not owned a dwelling for the previous three years.

First time home buyers are finding it increasingly difficult to afford a home and, therefore, need innovative financing programs in order to qualify for a mortgage. However, most ARMs do not carry any predictable payment schedule upon which a mortgagor can plan, because payments may vary as interest rates fluctuate. While first time home buyers can plan for scheduled income raises to balance projected mortgage payment increases, such as in the Section 245 GPM program, they may not be able to budget for unanticipated payment increases imposed under an ARM and, therefore, may be the subject audience least suited as a target for experimental financing.

Moderate income families who are current homeowners and have established careers and savings plans may be better served by ARMs and other experimental mortgage finance plans. In its concern over the needs of the first time home buyers who are coming into the home buying market over the next decade, Congress should not slight the needs of moderate- and middle-income home buyers who have traditionally relied on the availability of FHA mortgage insurance, because of its low downpayment requirements.

Increased mortgage amounts

MBA supports Section 102, which increases the maximum mortgage amount for two-to-four family units insured under the Section 203(b)(2) program, as necessary to encouraging investment in small multi-family dwellings, which can help to relieve housing shortages, especially in the multi-family rental market. However, MBA urges this Subcommittee to consider using a flexible sliding equation, similar to that currently provided by Section 203(b)(2) of the National Housing Act which provides for single-family maximum mortgage amounts in high cost areas. This offers greater flexibility, and more accurately pinpoints local needs by structuring the program to reflect local market conditions and prices.

Five-year mortgages

While MBA supports Section 201, which provides for, what is in effect, five-year ballon mortgages, as one more tool in the mortgage finance arsenal. However, MBA urges a longer maturity term, and suggests that a ten year term be set as the maximum. This would offer more flexibility in tailoring a mortgage to changing market conditions. Lenders could then fashion mortgages with different maturities ranging from three to ten years.

As a simple technical amendment, MBA suggests that Section 201(q)(2)(c) be amended to read: "bear interst at a constant rate" in order to avoid interpretation that the rate would be set at the current statutory maximum rate of six percent, rather than the maximum interest rate as determined by the HUD Secretary.

MBA supports the concept embodied in Section 202, which authorizes GNMA to guarantee mortgages insured under Section 201 of S. 1702. MBA would like to emphasize that the availablity of the GNMA-MBS secondary market finance alternative is crucial to the success of any proposed program.

Condominiums

MBA supports Sections 301 through 303, which eliminate pre-sale requirements for condominiums; increase the attractiveness of the blanket mortgage by basing it on 70 percent of the retail value of the sum of units, rather than the current 90 percent of HUD multifamily construction amounts; and remove Davis-Bacon requirements for Section 234 condominium projects.

Mortgage insurance for homes on leased land

MBA supports Section 401, which authorizes mortgage insurance for homes built on leased land. Whereas land and development costs constitute a major component cost, this authority offers one more opportunity for flexibility in structuring an affordable mortgage finance package for home buyers. This provision may be somewhat redundant in that Section 201 of the National Housing Act already includes this authority in its definition of a mortgage. However, that section restricts leasing to 50 and 99 year minimums, where the proposed provision does not.

Mortgage insurance for manufactured housing

MBA supports Section 501, which authorizes the HUD Secretary to insure homes that comply with the National Manufactured Housing Construction and Safety Standards Act of 1974, so long as the home is sited on a permanent foundation. Enactment of this provision would enable the Federal National Mortgage Association (FNMA) to buy mobile home loans under their August 1981 manufactured housing policy.

MBA suggests a technical amendment for Section 501(s)(2)(D). In order to avoid confusion, Section 501(s)(2)(D) should read as follows: "(D) be secured by a dwelling which must be permanently affixed to a foundation," rather than "be secured by a dwelling which is affixed to a site-built permanent foundation," as it currently reads.

Rehabilitation property standards

Although MBA supports the general thrust of Section 601, which liberalizes property standards for insurance on "shells" to be rehabilitated, MBA has several concerns with the provision. Section 601 would strike the requirement that older 203(k) properties comply with HUD Rehabilitation standards (which are not the same as Minimum Property Standards), and rely instead upon applicable local health and safety codes.

MBA suggests that rather than have HUD rehabilitation standards apply to properties less than 30 years old and local standards apply to properties 30 years or older, local standards should apply to all 203(k) loans with a HUD approval process similar to that now used for subdivisions. MBA believes that the requirement that the property be 30 years old or older is too restrictive, because it will prevent rehabiliation on structures where rehabilitation will change the use (from commercial, public etc. to residential), but which are not 30 years old.

MBA has reservations, however, about the wisdom of insuring a "shell" property with no quality standards whatsoever, except those imposed to varying degrees by local authorities. Another concern is the 5 year limitation on refinancing under 203(k). MBA questions the need to impose a refinancing deadline under that section when no such restriction is placed on FHA loans in general.

This concludes our comments on the contents of S. 1792 itself. We would, however, like to take this opportunity to comment on several amendments that MBA proposes, as well as the direction that we feel is appropriate and necessary for the FHA to follow in the future.

Free FHA interest rate

MBA commends HUD Secretary Samuel R. Pierce for his careful monitoring of the market and the promptness with which the FHA rate has been adjusted, both up and down, in accordance with changing market conditions. We can only regret that such diligent supervision and action has not always occurred in the past. Therefore, in order to assure that FHA/VA interest rates closely follow changes in mortgage market rates in the future, so that the disruptive conditions of recent years are not repeated, MBA strongly urges the Congress to adopt legislation that frees FHA/VA mortgage loans from any interest rate controls, either on interest rates themselves, or on discount points.

Removal of the interest rate ceiling on FHA-insured mortgage loans would be a major action to reduce the inflationary pressures on the costs of homeownership for millions of Americans. FHA loan prices to the consumer are composed of the interest rate on the loan and the amount of discount, commonly called "points," necessary to make the yield of the mortgage loan conform to market prices.

If the FHA-established interest rate ceiling is far below current market rates, the amount of discount needed to market the loan at the investor's required yield will be extremely high. And since by law the home buyer using FHA financing cannot be charged the necessary discount, the seller must pay it if he wishes to sell to the FHA buyer. Sellers recapture the points by increasing their sales prices and as a result sales prices are artificially inflated. Because FHA sales prices, and only FHA

sales prices, are used in calculating the Consumer Price Index (CPI), the distortion is magnified and reverberates through the economy.

In addition, there are maximum mortgage amounts that can be borrowed under FHA programs, and the buyer can find that the extra points required because of the artificially low interest rate can create a higher sales price that is beyond the buyer's capacity to purchase. The time necessary for a rate change to be implemented creates lags and distortions in the secondary market, reducing efficiency. If there were not an artificial ceiling on the FHA interest rate, the cost of housing would be determined by the interaction of buyers and sellers in the marketplace. In addition, the lender would not need to charge heavy discounts in order to bring the loans to required market yields, and both the primary and secondary markets could function without the restraints that require compensating behavior and distortions in price and affordability.

Due-on-sale

MBA urges the inclusion of a provision in S. 1702 that would permit lenders to insert and enforce due-on-sale clauses in FHA-insured mortgages. Assumable mortgages that do not contain a due-on-sale clause would have an interest rate that reflected the premium demanded by the market place for such a feature, while non-assumable mortgages would bear a lower interest rate.

The ready assumability of FHA-insured loans increases the average term of FHA-insured mortgages, and hence the lender's exposure to inflation. In order to compensate for this uncertain and increased exposure to inflation, the market demands a premium. This premium causes the interest rate to be higher than it would otherwise be, absent the assumability feature of FHA-insured mortgages.

We believe that this is directly contrary to the purpose of FHA, which is to provide moderate-income families with opportunities for affordable homeownership. Requiring free assumability of FHA-insured mortgages makes homeownership *less* affordable for moderate-income families. We urge this Subcommittee to authorize due-on-sale clauses in FHA mortgages so that moderate-income borrowers can choose the financing alternatives suitable for their incomes.

CONCLUSION

As Congress reviews new directions for FHA, it should also give due consideration to the role of FHA in the past, and its future continuing function, as a viable source of mortgage finance for moderate- and middle-income home buyers. While the experimental financing techniques embodied in this proposed legislation will reinforce FHA's role as a creative leading edge in the market, it is equally important not to foresake FHA's traditional role as the insurer of the fixed rate, long-term mortgage, which FHA pioneered. This also emphasizes the need not to cripple the FHA mortgage insurance and GNMA-MBS guaranty program with restrictive ceilings.

As thrift and bank lenders turn increasingly toward ARMs, as a means of balancing interest rates on assets (mortgages) with interest rates payable on deposits, the FHA Section 203(b) program could become the last bastion of the fixed rate, long-term mortgages. FHA, with its ready access to the capital markets via the GNMA-MBS instrument, may be the only source of fixed rate, long-term mortgage finance in the future—and therefore, this program will play a valuable social role in preserving the alternatives for moderate- and middle-income homebuyers, especially the first-time home buyer.

While the interest rate of the fixed-rate, long-term mortgage will probably be somewhat higher than the interest rate on ARMs, or other creative financing instruments, we believe that it is an important option to preserve, in order to serve all types of mortgagors with their variety of interests. Certain groups, such as retirees who must live on fixed incomes, would obviously be willing to trade off a slightly higher interest rate for the assured benefit that interest costs would not fluctuate with market rates when their income could not be expected to track market variations.

MBA would like to take this opportunity to thank the Chairman of this Subcommittee for his foresight in introducing S. 1702, which seeks to keep the FHA programs abreast of developments in the mortgage marketplace. Should there by any questions, MBA would be most pleased to provide answers for this Subcommittee.

EXHIBIT I

Mutual mortgage insurance fund

The Mutual Mortgage Insurance Fund (MMIF) was established in 1934 to provide reserves for the FHA Section 203 home mortgage insurance program. The Section 244 Coinsurance and Section 245 Graduated Payment Mortgage programs were added as recently as 1974 and 1977, respectively. The MMIF is self-sufficient by any measure. The Treasury borrows from its reserve fund, thereby reducing Federal borrowing in the private credit markets as well as the Federal cost of borrowing. Mortgage insurance premiums are paid into reserve accounts: one reserve covers losses and the other, a participation reserve account, was established for the payment of dividends. Additionally, the MMIF covers all administrative expenses connected with the programs it covers, including salaries, rent, overhead, etc.

General insurance fund

The General Insurance Fund (GIF) was established in 1965, and is used to insure mortgages under various socially desirable programs, some of which are high-risk insurance programs that might have been placed in the Special Risk Insurance Fund, had it been established at that time. The cumulative deficit of $2.7 billion in the GIF is attributable primarily to the high-risk programs contained in the fund and also to the transfer of GIF moneys into the Special Risk Insurance Fund when it was established. Although the fund was intended to be actuarially sound, the placement of high risk programs in this fund affected that intention. The inclusion of special risk programs, notably the Section 221(d)(3) below-market-interest-rate rental program for low- and moderate-income families, which does not even charge an insurance premium, has diminished the GIF and required the transfer of funds from the MMIF, as well as additional appropriations and Treasury borrowing.

Nonetheless, a number of the programs classified under the GIF have low claims rates avidencing their actuarially sound nature. Otherwise, the major difference between the GIF and the MMIF is that the GIF is not designed to pay dividends to mortgagors—it is simply designed to cover losses reasonably projected under its programs and administrative expenses. Like the MMIF, administrative expenses are also paid from this fund.

Cooperative management housing insurance fund

The Cooperative Management Housing Insurance Fund (CMHIF) was instituted in 1965. Currently it is successfully operating with a positive reserve of $21.2 million generated from payments of mortgage insurance premiums. Like the MMIF, it is designed to be actuarially sound, to cover administrative expenses, and to pay dividends to participating mortgagors, whenever reserve requirements are exceeded.

Special risk insurance fund

The Special Risk Insurance Fund (SRIF) was established in 1968. It is intended to provide mortgage insurance for (1) subsidized mortgages for low-income mortgagors, (2) low- and moderate-income mortgagors with irregular income patterns or credit histories, and (3) properties located in older, declining urban areas. Originally the SRIF was funded with a $5 million advance from the GIF, and by 1975 a total of $20 million had been advanced from the GIF. The SRIF has never been, nor was it designed to be, actuarially sound. The programs it covers, however, are not pure demand programs; rather, they are subject to Congressional appropriations and contract authority limitations. This limits the potential liability of the Treasury and gives the Congress an opportunity to determine annually how large the program should be.

EXHIBIT II

Sec. 247(e)

(1) Without regard to any limitations that otherwise would be imposed on such a lender by the constitution, statutes, court decrees, common law, rule, and public policies of any states, a qualified lender or his transferee may make or purchase home mortgage loans in conformity with regulations promulgated by the Secretary of the Department of Housing and Urban Development pursuant to the authority provided in Sections 203(q) and 247.

(2) The Secretary of the Housing and Urban Development is authorized to issue rules and regulations and to issue interpretations governing the implementation of this Section.

Senator LUGAR. Thank you very much, Mr. Gourley.

Mr. Waldo, I'd iike to ask you this question, although other members of the panel might want to offer additional responses.

LIMITS PLACED ON FHA

How would you limit FHA so that it does not compete with the private mortgage insurance companies? Can you give us some parameters of the limits that you would like to see placed?

Mr. WALDO. I think probably the best way is to put limits on the amount of loans that can be insured, to put limits on home buyer qualifications such as income limitations, perhaps to tailor some limitations comparable to those that are now contained in the Uhlman bill with respect to municipal revenue bonds.

Senator LUGAR. Does anybody else have a comment?

Mr. GOURLEY. I think to limit FHA now would be a mistake. Ultimately there may be some limits that could be placed on FHA that might be appropriate to cause it to be noncompetitive. One of our concerns at the moment is sort of the backdoor approach to limiting FHA that has taken place with the reduction of the GNMA credit guaranty limit.

Mr. WALDO. Senator, we agree that none of these changes should be abrupt, that they should be phased, but we think there's never an appropriate time to make a change and we therefore feel the change should start now and to be contemplated over a period of time. Certainly I agree that the GNMA—and I said this before—that the GNMA security is a very important part of the secondary financing of home mortgages right now. Our concern, though, is that unless there is a beginning of the phasing out of both the FHA and GNMA programs, the conventional mortgage-backed securities aren't going to have a chance to develop.

Mr. HART. I think it would be important for me at this time to tell you that the State of Indiana's public employment retirement fund, which has about a billion dollars in it—one of your goals is attempting to remove the obstacles in their investing in mortgage-backed securities—are bound by a state constitution requirement that we can only put pension funds in federally insured instruments. You're going to find this in a lot of States.

Second, there's a phenomenon that's just happened in the last few days in the bond market where municipalities or schools or housing bonds are going to the marketplace with an obligation to long-term bond buyers for interest rates and are coming out of the marketplace with $50 and $100 million that has a reverse arbitrage. They're going back to Treasury bills that carry less yield than on the bonds which will absolutely destroy the marketplace unless they find a Government-backed security such as GNMA to substitute for low yield Treasury bills. The GNMA or Government-backed securities yields will more directly relate to bond yields. If we could ever get the deficit of the Federal Government down and keep it out of the money markets, it would be a good investment for the prudent investor of public funds put to their funds in a GNMA-backed mortgage. We've got to keep that in the back of our mind.

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FHA-INSURED MORTGAGES FOR SHELL HOMES

Senator LUGAR. Let me ask this question of any member of the panel. Should we or how could we use FHA-insured mortgages for new homes that have a purchaser that tries to do painting or finishing work, sweat equity, in the home? Have any of you had experience with that sort of situation and should FHA have a program that encourages self-help?

Mr. HART. They have done this in the past and it usually occurs in a time like we're having right now. In fact, one of the more active markets that we have today in Indiana is the shell home. Cap Homes had 10 or 12 sales in the last 2 weeks, all unfinished on the inside.

They are appraising the shell for the loan and the lender has to make sure that there are adequate ability and funds to finish the product and will the market value be at that time—be within reason of the completion costs. The only true work equity that we have worked under FHA is where the customers did their own painting or grading, these type of simple labor operations were very effective.

Mr. GOURLEY. We see these for existing construction and for finished houses where we have escrowed the funds for subsequent disbursement 3 or 6 months later.

CONDOMINIUM LOANS FOR INVESTORS

Senator LUGAR. Let me ask this question of the panel. Would it help or hurt FHA, in your judgment, if we allow FHA to insure condominium loans for investors?

Mr. WALDO. Condominium loans for investors—you mean not owner-occupied?

Senator LUGAR. Yes.

Mr. WALDO. Well, the private sector tries to not avoid investor loans, but we certainly put different underwriting criteria on those loans and we accept different loan evaluations.

Mr. GOURLEY. It could help the rental market. I think FHA could do it safely with proper downpayment and proper underwriting on the part of the lender so that that could be very pertinent and is being used as a matter of fact.

Mr. HART. I think it's being done now with one- to four-family houses. I think their (one to four units) problem is in the loan limits. The condominium move from 234 to 203(b) is only adding garden apartments to the program that already exists on town-houses and ranch-attached units. The garden apartment or what we call stacked units is the only addition we recommend.

Senator LUGAR. Gentlemen, you have been most thoughtful in addressing all the sections of the bill in your prepared statements and of course in your summaries you have touched on many of them, and that testimony will all be made a part of the record. We are grateful to you for coming this morning and taking part in these hearings.

The Chair would like to call now a panel consisting of Gale Cincotta, National Training and Information Center of Chicago, Illinois; and Allan Fishbein, Center for Community Change, Washington, D.C.

Ms. Cincotta and Mr. Fishbein, we welcome you again as regular participants in the work of this subcommittee and the full committee. We are grateful to you for coming this morning. I'd like to ask you to testify in the order that I called you to the table. First of all, Ms. Cincotta.

STATEMENT OF GALE CINCOTTA, NATIONAL TRAINING AND INFORMATION CENTER, CHICAGO, ILL.

Ms. CINCOTTA. Thank you for inviting me here.

Over the last 18 years, both while living in a Chicago neighborhood and being involved as a leader in my neighborhood, as well as a member of NPA and executive director of NTIC since 1972, I have been involved with home financing issues, FHA as well as conventional.

Dealing with FHA has always posed a problem of seeing it as an essential funding mechanism, therefore wanting to make sure that it exists and, on the other hand, spending much time trying to clean it up and make sure that it functions properly.

Alongside of that, I've spent a lot of time making sure that the conventional finance market was working and available to people in city neighborhoods.

In the early 1960's, FHA-insured mortgages were practically nonexistent in the cities. In the late 1960's and early 1970's FHA was loosened up and came into the cities to fill a void left by conventional lenders who were redlining the city neighborhoods. This brought out many problems and a high inventory of abandoned FHA homes. Regulatory changes were needed and fought for and won, but the great majority of people who bought in FHA in the cities stayed in their homes, paid their mortgages, and found access into the system.

Again because of the fine line of trying to clean it up and not kill it, with the FHA-HUD changes we were able to help influence, and the targeted rehabilitation program, and also with the use of the home mortgage disclosure bill, and CRA in existence, we started to see a healthy mix of FHA and conventional mortgages and neighborhoods starting to turn around.

The national FHA inventory of single family vacant buildings dipped very low.

In the past 2 years we have seen mortgage interest rates skyrocket, S. & L.'s as traditional home financing institutions gutted, all sorts of ARM's and AML's and variable-rate mortgages proliferated and housing tremendously downplayed as a national priority. Instead of the fixed-rate, long-term, low-interest mortgages, it seems like Congress and the regulatory bodies and financial institutions have bought into the inflationary syndrome. Now today, we are here to discuss changing FHA in similar ways.

I think the questions that we should be asking ourselves are; who are the people FHA should be serving and, two, how much money is Congress going to allocate to FHA 203 and how can we assure that FHA 203 serves the maximum amount of people in need of affordable housing finance with the money being allocated?

Also, if the Government-financed housing programs are going to buy into an inflation mentality, what will be the result.

The first proposed change in S. 1702, section 101, would open the floodgates for FHA-insured lenders to replace long-term, fixed-rate mortgages which have served our country's housing needs so well for nearly 50 years—replace them with short-term, variable rate and balloon payment mortgages which have historically caused instability and widespread foreclosure in the housing market. We have already begun to realize the impact of recent mortgage changes.

FORECLOSURES UNDER BALLOON AND CONTRACT SALE

The Mortgage Bankers Association of America reports that 1 in 20 loans is delinquent nationwide. That's the highest delinquency level since the association began taking surveys for delinquency 27 years ago. Predictions for defaults and foreclosures under recent balloon and contract sale mortgages are frightening. Brokers quoted in a recent Wall Street Journal article are saying if a crunch comes, it's likely to develop next year. There's going to be a lot of ballooning in 1982. Legally, the contract and mortgage holders could foreclose if the homeowners are unable to come up with the principal that's due.

Foreclosure filings have already doubled recently in California because of creative financing, balloon mortgages, and land contracts, according to the T.D. Mortgage Service Co. that services nearly three-fourths of the foreclosures in California. Their average per month in 1980 was about 900 foreclosures. Now, in 1981, they're up to about 1,800 foreclosures per month.

The second change in section 102, would allow significant increases in the loan limits for two-family, three-family, and four-family homes insured by FHA. I'd like to point out that the proposed higher ceilings would result in greatly minimizing the number of families served by FHA. For instance, let's take the case of a proposed two-family home ceiling of $120,000: Under the current rules, the ceiling is $76,000. The monthly payment for a $76,000 mortgage at 17 percent is $1,092. Using the traditional 25 percent of income rule of thumb, the income to borrow on this loan would already be $52,000 plus. Consider the monthly payments under the proposed higher ceilings of $120,000. The buyer's monthly payments at 17-percent interest would be over $1,700.

Using the same rule of thumb, you're talking about eligibility of income for somebody making over $82,000 a year. If that $120,000 loan is a rollover and goes up two points, the payments rise to almost $2,000 a month and the income rises to $92,000. And so on, every time you would increase the interest on the loan you are going into a very, very high income level.

My question is, Is that the income group that HUD and FHA should be allocating their limited financing to? Practically speaking, also, if you keep a lid on the amount of mortgages, say the top figure of $76,000, instead of servicing only maybe 14 families, you could service 20 families getting them into homeownership.

The reason that we object to this is the fact that these increases seem clearly intended to encourage the building of expensive new homes in the suburbs which have the most land, at the expense of

maintaining existing moderately priced homes in lower income neighborhoods in the city.

This is a repeat of the past discriminatory and wasteful FHA policy of favoring new suburban housing over older city housing.

EXODUS OF FHA FROM CITIES

I would like to give you some figures that reinforce our concern about the current exodus of FHA from the cities. In the 1950's and 1960's, virtually all the FHA-insured homes were located in suburban areas, spawning the growth of the suburbs. Then in the 1970's, after the suburbs were more built up and the late 1960's riots occurred in the cities, it focused its attention on urban housing needs. FHA moved into the city.

In 1975, 69 percent of FHA's 203 loans made in the entire Chicago metropolitan area were in the city of Chicago; only 31 percent were in the suburbs. That was the 1970's. Now the pendulum has swung again. Last year, 1980, the city share of FHA 203(b) dropped from 69 percent to 16 percent. In 1980, 84 percent of the FHA 203 program loans went to the suburbs.

I would venture to say that the proposed changes in S. 1702 would take away our 16 percent. That's in a time when we need to increase availability of affordable housing in the city.

The other thing I'd like to point out is we think FHA 203 should be kept at about 2 percent below conventional rates without prohibitive points. The lender is 100-percent insured. His risk is zero, and I think that should be worth a lot to have a 100-percent insured loan, at least a percent or so.

The other thing I'd like to raise is some points about FHA section 235, even though we're not dealing with it in the bill today. I'd like to bring up that the 235 program is an essential program, especially the way interest rates have been and nonavailability of conventional financing. We feel it should be expanded and should also be expanded heavily to cover existing homes. This program is the only source of financing for thousands of families whose income would not qualify them even under 203 or in the conventional financing.

The other thing is if you're going to include condominiums and manufactured homes as proposed in S. 1702, you're radically expanding the choices for FHA-insured home buyers. It is therefore even more important that mortgage ceilings be kept moderate. Lower ceilings will somewhat assure greatest benefit among the moderate and lower income groups. Lower ceilings will again maximize the impact of the FHA programs.

In closing, I'd like to reiterate the value of maintaining FHA as a fixed-rate, long-term mortgage program. Benefits of long-term, fixed-rate mortgages and the drawbacks of short-term variable rate mortgages were plainly stated by the Chairman of the Federal Home Loan Bank Board in a nationwide radio address delivered on May 1, 1934, and entered into the Congressional Record by Senator Walsh. Along with the 73d Congress, he gave his full support for replacing short-term mortgages with long-term, fixed-rate mortgages.

OPPOSED TO ALTERNATIVE MORTGAGE INSTRUMENTS

I have a two paragraph quote here where he talks about how important it was to do away with balloons and short-term financing and how beneficial both to the lender and the homeowner the long-term, fixed-rate mortgages are; and for us to just go back 50 years where we have had something that's served people well is just very scary.

In my neighborhood in Chicago and most of the cities I deal with, you're using creative financing which is owner-financed, contract sales, balloon mortgages, and the situation is just absolutely desperate. We're liable to see the same kind of problems that faced our cities in the 1960's and precipitated some of the riots.

We oppose passage of S. 1702 and we oppose further authorization of alternative mortgage instruments, particularly with FHA-insured rollovers. We oppose it because we think that with limited FHA resources it's just bad use of the money.

We'd also like to urge that the committee focus the Senate's attention on lowering interest rates in general and securing again fixed-rate, conventional mortgages and assuring the American people a return to homeownership and housing as a national priority. We think that it served this country well and I'm very frightened that because of the Fed's policy of tightening money that we have just radically changed the whole housing picture and it's going to be bad, especially for low- and low-middle income people. Thank you.

Senator LUGAR. Thank you very much, Ms. Cincotta.

Mr. FISHBEIN.

STATEMENT OF ALLAN FISHBEIN, CENTER FOR COMMUNITY CHANGE, WASHINGTON, D.C.

Mr. FISHBEIN. Thank you, Mr. Chairman. I welcome the opportunity to appear here today to testify on Senate bill 1702.

Before I begin my testimony, I would like to say a word about the Center for Community Change. The center is a Washington based nonprofit organization providing technical assistance to low and moderate income and minority community organizations around the country. Much of our work has concerned issues of neighborhood reinvestment, the impact of FHA and VA in urban neighborhoods, and the role of the mortgage banking industry on urban lending.

In my remarks today I would like to summarize a few of the points which are contained in more detail in my written statement.

S. 1702, among other things, would give HUD broad discretionary authority to insure adjustable rate loans and require the implementation of certain new insurance programs, including a 5-year rollover mortgage program.

As I stated in my written testimony, we have serious reservations with both of these sections of the bill. Mr. Chairman, we certainly share your desire to see FHA remain an innovator in mortgage financing and respond to new market conditions. Additionally, we share your desire to see FHA programs better able to meet the needs of the marginally qualified buyer, young families and others, for whom conventional financing would not be suitable.

However, we believe that permitting HUD to engage in any significant way in insurance on an adjustable rate and short-term rollovers would be counterproductive to these aims.

UNRESTRICTED ADJUSTABLE RATE MORTGAGE LENDING

To best understand our view, it is necessary to place the bill in the context of the changes that are going on in the overall mortgage market. High interest rates have brought the real estate market to its knees but, at the same time, the new Federal regulatory rules permitting unrestricted adjustable rate mortgage lending have greatly accelerated the use of those instruments by conventional lenders. The use of ARMS can be expected to increase as interest rates begin to come down, and it becomes more advantageous to lenders to make adjustable rate mortgages.

While the widespread use of adjustable rate mortgages may increase the availability of mortgages in some segments of the homebuying markets, those people whose income can be expected to increase at a faster rate than the rate of inflation, there is no indication that things will increase the affordability of mortgage lending.

Initial surveys have shown that the spread between the traditional fixed-rate mortgage and the adjustable rate mortgage, which was originally sold as a way of making mortgage financing cheaper, is usually less than one-half of 1 percentage point, and there's already some evidence that adjustable rate mortgages are beginning to crowd out the standard fixed-rate mortgage from the market.

It's our feeling that this trend to adjustable rate mortgages, particularly if it leads to the demise of the fixed-rate mortgage altogether, will put homeownership out of reach of people of modest means and limited upward mobility on a permanent basis. The moderate income buyer will not have the income flexibility to allow him or her to obtain a loan, and even if they could, it may not be a good investment on their part.

Any limitation on homeownership in urban areas would have a disastrous effect undercutting many of the revitalization activities that the Federal Government and local governments have been promoting over the last 10 years.

LEGISLATION TO GUARANTEE PROTECTION ON ARM'S

Accordingly, we have joined with a coalition of over 60 national and local groups that's urged Congress to enact legislation which would guarantee protections on adjustable rate mortgage lending and establish policies to assure the continued availability of the standard fixed-rate mortgage for the marginal homebuyer. The coalition fervently supports the view that the basic FHA loan insurance programs should remain on a fixed-rate basis.

The net effect of this transformation of the mortgage market will be to leave FHA as the primary source of fixed-rate mortgage lending in the future. However, at the same time, the demand for low downpayment, fixed-rate loans is likely to be expanding rapidly, at least for the marginal homebuyer, the administration is proposing to reduce the role of FHA by setting annual ceilings on

aggregate lending below projected demand. We fear that S. 1702 could have the effect of further depleting this already dwindling supply of fixed-rate loans, since any move by HUD at this time to undercut significantly fixed-rate lending could have a disastrous effect on the conventional market as well.

Furthermore, the coalition believes that FHA should be exempt from any budget ceilings and thus be allowed to expand according to market demand. As I said before, we think it is premature for HUD at this point, to move away from fixed-rate insurance on an exclusive basis, along the lines proposed in S. 1702.

In closing, I'd like to comment on two specific provisions contained in the bill.

Title I provides for experimental authority. Our major fear here is that this title would provide for an open-ended use of adjustable-rate mortgage insurance without imposing any limitations. Conceivably, FHA could use this authority to convert most of it's programs over to an adjustable rate basis.

Second, if the committee should grant HUD this experimental authority, we are concerned that no consumer protections are provided in the legislation. HUD would really be missing the boat if they fail to set strong consumer protections on adjustable rate mortgage insurance, since it could help to standardize this type of instrument with lenders.

Title II provides for short-term rollover, and we have similar concerns with this part of the bill once again, there's no limit on the extent to which the HUD can use this program. We do not believe that the short-term rollover will increase the availability of mortgage lending for the marginal buyer and this instrument doesn't even contain minimum protections, such as guaranteed refinancing for the borrower or ceilings on the extent that the interest rates could be increased.

Finally, I just want to say that there are a number of people, including some in the administration, who have been questioning the role of FHA and the extent to which it duplicates the activities performed by the private insurance market. We believe that in such times as these, FHA should be creating a niche for itself in the insurance market, and we don't see a better way for it to accomplish this function than by remaining the primary insurer of the fixed-rate mortgage loan. Thank you, Mr. Chairman.

[Complete statement follows:]

TESTIMONY OF ALLEN J. FISHBEIN, DIRECTOR, NEIGHBORHOOD REVITALIZATION PROJECT

Mr. Chairman and members of the Subcommittee, my name is Allen J. Fishbein. I am the Director of the Neighborhood Revitalization Project, which is a special project of the Center for Community Change. The Center is a Washington based, not-for-profit organization, providing technical assistance to community organizations across the country that represent lower-income and minority constituencies. Much of the Project's work has revolved around community reinvestment, the role of FHA and VA in neighborhoods, and the impact of the mortgage banking industry on urban lending. We have published several reports on FHA and on mortgage bankers, including, "Opportunities for Abuse: Private Profits, Public Losses and the Mortgage Banking Industry" and "Response to Crisis: A Study of Public Policy Toward Neighborhoods and Fair Housing," in which we explored the role of FHA in racial steering in a neighborhood in Chicago. In addition, last month we published a report documenting the serious dangers posed by unrestricted adjustable rate mortgages (ARMs) entitled, "Runaway Mortgages: A Review of the Early Experience

With Unrestricted Adjustable Rate Mortgages and an Analysis of the Implications of Negative Amortization.

I welcome this opportunity to appear before the Subcommittee this morning to present our views on S. 1702, the "FHA Revitalization Act of 1981." The Chairman's bill would give HUD broad discretionary authority to insure adjustable rate loans and require the implementation of certain new insurance programs, including a five-year rollover mortgage program. In introducing the bill, Chairman Lugar stated that such a restructuring of FHA is desirable if that agency is to continue to meet the needs of the "marginally qualified buyer, young families and others for whom conventional financing will not be suitable." While we endorse Senator Lugar's view, that FHA should be geared to the marginally qualified buyer, we believe that Titles I and II of S. 1702 would be counterproductive to that aim. It is our view that any significant shift away from FHA's traditional fixed-rate, level payment mortgage insurance programs, would have quite the opposite effect, severely limiting the availability of mortgage financing for the marginal buyer. While we are not adverse to seeing FHA maintain its role as an innovator in housing finance, we believe that role should be limited to developing a number of new fixed rate financing alternatives.

The provisions of S. 1702 should be viewed in the context of the tremendous changes which are presently occuring within the conventional mortgage market. The recent regulations issued by the Federal Home Loan Bank Board and the Comptroller of the Currency have greatly accelerated the move by S&Ls and banks toward adjustable rate mortgages (ARMs). These new types of mortgage instruments allow lenders to pass on the risks of inflation to borrowers, by allowing adjustable to interest rates, monthly payments, and loan balances according to the rise of prevailing market rates. Neighborhood and consumer groups predict that the widespread use of ARMs will make homeownership more difficult and uncertain for millions of Americans, thus setting the stage for a massive wave of foreclosures, and the resurgence of redlining.

Perhaps even more ominous are the predictions that the move to ARMs could signal the demis, or at least the sharp curtailment of the standard fixed rate mortgages. Saul Kaman, President of the National Association of Mutual Savings Banks commented recently that, "There is no longer any place in the savings association portfolio for a long-term, fixed rate mortgage." The virtual elimination of the conventional fixed rate mortgage is likely to hamper most severly, homeownerhip opportunities for the family of modest means and limited upward mobility—the truly marginal home buyer.

Accordingly, the Center has formed a coalition with more than sixty national and local civil rights, labor, neighborhood, church and consumer groups which called upon Congress to enact legislation which would guarantee reasonable protections for borowers who obtain adjustable rate mortgages, and to establish policies to assure the continued availability of standard fixed-rate mortgages for the marginal home buyer. The Coalition fervently supports the view that the basic FHA mortgage loan insurance program should remain on a fixed-rate basis. A copy of the Joint Statement issued by the coalition is included as part of my testimony.

Evidence is already beginning to mount that ARMs are crowding the standard fixed-rate mortgage out of the market. A survey we completed this summer, which is contained in our report on runaway mortgages, documents the remarkable speed with which lenders are moving to ARMs, at least in some cities. We found that many lenders have already eliminated their fixed-rate lending, and now offer only ARMs. There are indications that many other lenders are likely to drop fixed rate loans in the near future. For example, five out of six S&Ls surveyed in Akron, Ohio 3 out of 5 thrifts in Rochester, New York, and 12 of 25 S&Ls have eliminated fixed rate loans in favor of ARMs.

A recent survey by the American Mortgage Insurance Company reached a similar conclusion. AMIC found that two-fifths of all S&Ls currently offered ARMs, but that two-thirds will likely offer them by the end of the year, and that a substantial percentage of those making ARMs had stopped offering fixed-rate mortgages.

The net effect of this transformation in the conventional mortgage market will be to leave the FHA market as the primary source of fixed rate mortgage lending. Even the federal financial regulatory agencies readily acknowledge that are looking to FHA insurance programs to help assure the maintenance of fixed-rate lending. At the same, it would appear that GNMA mortgage-backed securities will continue to be in demand in the capital markets. Since FHA is targeted to the bottom half of the housing market, with data indicating that most FHA insurance buyers purchase homes well below the median sales price, it would seem logical for the agency to continue to insure fixed rate loans on an exclusive basis.

Unfortunately, while it would seem that the demand for low downpayment, fixed-rate loans insured by FHA will be expanding rapidly, for at least a certain segment of the housing market, the Administration is proposing to reduce the role of FHA by setting annual ceilings for an aggregate FHA lending below the projected demand. S. 1702, which authorizes HUD to develop ARM and rollover insurance, could further deplete the already limited supply of fixed-rate loan insurance.

The coalition believes that FHA should be exempt from any budget ceilings and this allowed to expand according to market demand. Additionally, we believe that it would be premature for HUD to move away from an exclusive fixed rate basis for its basic insurance programs.

Now, I would like to comment on some specific provisions of S. 1702:

TITLE I

Section 101. Experimental insurance authority

This section provides for extremely broad and open-ended grant of discretionary authority to HUD, presumably to experiment with adjustable interest rate loan programs. These programs would be limited by only one restriction, that the insurance could be provided to a borrower who owned a unit within the past three years. The restriction is apparently based on the belief that first time homebuyers should be the sole beneficiaries of ARM lending. It is not clear, however, whether ARMs will be affordable to many first-time home buyers, particularly those with modest means and limited upward mobility.

As I indicated above, we are strongly opposed to this provision in present form. We believe that FHA loan insurance should remain on a fixed rate basis. It is important to note that, while this section is entitled, "Experimental Insurance Authority," there isn't any language in the text indicating the experimental nature of the discretionary authority. Moreover, Section 101 of the bill does not set any limitations on the extent to which the new insurance programs could be used in any given year. Thus, it is conceivable that an adjustable interest loan insurance program could become a significant, substantial, or even the principal FHA insurance program, under the authority delegated to HUD in section of the bill.

Another major concern of ours, is that this section does not set any minimum eligibility standards for insuring an adjustable interest rate mortgage. For example, the bill does not mandate any consumer safeguards, limits on monthly payment increases, interest rate caps, or fixed-rate mortgage option requirements. We believe that these requirements should be built into the legislation, since FHA would be in a strong position to influence the standardization of ARMs, in much the same way that it pioneered various aspects of the long term fixed-rate mortgage.

Section 102

This section would increase the mortgage limits for loan insurance for two, three, and four unit structures to $120,000 (up from $76,000), to $180,000 (up from $92,000), and to $240,000 (up from $107,000, respectively).

We question the necessity of the proposed changes in the dollar loan limits, which represent a substantial increase over existing limits. At a time when FHA has come under attack by some in the Administration for duplicating the market served by private mortgage insurers, we would prefer to see efforts directed toward targeting FHA to the bottom half of the mortgage market.

We also note that the increases in the dollar amounts represent a departure from the area differential concept, which permits HUD to increase the maximum loan amount on an area-by-area basis. Over time, the area differential provision in the existing Section 203(b) would permit FHA loan limits to reflect regional variations in housing markets. We recommend that the Subcommittee consider increasing the percentage ceilings instead of increasing the actual dollar loan value, providing there is sufficient justification for allowing loan limits to increase at this time.

TITLE II

Section 201

The Section provides specific authority to HUD to insure five-year rollover mortgages.

Once again, we are strongly opposed to this provision in its present form. As with Section 101, this section provides enormous, open-ended discretion to HUD to devise a five-year rollover insurance program. Unlike Section 101, however, this program is not offered as experimental program. What is more, we are disturbed by the fact that there is no limitation placed on the extent to which FHA could insure rollover mortgages in any given year. Further, the bill does not specify the type of five-year

rollover which should be developed. For example, this provision could permit HUD to insure a five-year mortgage with a balloon payment, with no guarantee for refinancing to the borrower. And once again, this does not provide for any consumer protection standards.

Should Congress adopt this provision, we would strongly urge that it build in strong consumer safeguards or ceiling on the rates which may be offered by refinancing. We would urge strict limits on the extent to which this program could be used in any given year. As with Section 101, FHA could play an important role in bringing about the standardization of this type of mortage instrument.

The recent decisions by two New York savings banks to demand payment on low-rate, short-term mortgages points up some of the dangers inherent in the rollover mortgage loan. In Buffalo and Kingston, New York, customers of two banks signed up for "call" loans that gave the banks the right to declare the mortgage due and payable at the end of five year period. Although the banks offered to refinance the mortgages, it was a rate that was almost double the old one, and the ensuing public protest by homeowners eventually made the Buffalo bank rescind the move. Similar problems have been reported with the Canadian rollover mortgages, further underscoring the potential difficulties in insuring this type of loan, particularly if there are no requirements for adquate disclosure to borrowers and other protections.

Title VI—Property Standards

Section 601

Authorizes HUD to make homes over 30 years old eligible for Section 203 insurance if they meet local codes, but not necessarily HUD's minimum property standards.

We are concerned with the language in Subsection (1) which makes properties that were acquired for the purpose of rehabilitation eligible for insurance, although it does not appear that rehab would actually be required. This change could open the door to FHA insured speculation, at least in certain areas.

In closing let me say that, for almost half a century, federal housing policy has sought to increase homeownership opportunities for most Americans. Homeownership has been wisely regarded as an effective means of enabling many families to acquire an economic interest in the stability of their neighborhoods. FHA has often played an important role in making that policy a successful one. We share the desire to see FHA continue to play a innovative and creative role in increasing the availability of homeownership for the marginal homebuyer. We believe, however, that that role can best be achieved, at least for the present time, by maintaining the FHA loan insurance program on a fixed rate basis.

This ends my formal testimony. I would like to thank you again, Mr. Chairman, for the opportunity to testify before this Subcommittee on this vital issue, and I will be glad to answer any questions that you might have.

Joint Statement of Adjustable Rate Morgages [1]

Introduction

Recent actions by Federal regulators and Federal secondary market agencies have virtually wiped out borrower protections in adjustable rate mortgages, and threaten to eliminate standard fixed rate mortgages. Unless strong corrective action is taken by the Congress, a fundamental and extremely adverse change in the entire nature of home financing in this country will occur, making homeownership more difficult and uncertain for millions of Americans.

We call upon the Congress to enact legislation to guarantee reasonable protections for borrowers who obtain adjustable rate mortgages, and to establish policies assuring the continued availability of standard fixed rate mortgages for those borrowers who need such mortgages.

Recent Actions by Federal Regulatory and Secondary Market Agencies

The regulatory changes that have been adopted by the Federal Home Loan Bank Board obliterate all previous borrower protections. For example, the new regulations set no limits on the potential increase in the interest rate or the potential increase in the monthly payment. In addition, these new regulations explicitly authorize negative amortization, whereby the outstanding loan balance could be

[1] This statement is being issued by 60 national and local civil rights, labor, neighborhood, church and consumer organizations. See end of statement for the list of organizations.

increased instead of decreased over time. No ceilings are set on the amount or rate of negative amortization.

The regulations adopted by the Comptroller of the Currency do not entirely wipe out the concept of borrower protection. Nevertheless, the Comptroller's regulations are wholly inadequate. For example, the regulations have preempted the laws of a number of States which limit interest rate increases to ½ percent a year. By contrast the Comptroller allows national banks to increase the interest rate by 1 percent every six months, or 2 percent a year. A 2 percent a year increase in the interest rate could mean an increase in the monthly payment of 15 percent or even 20 percent a year, which far exceeds the rate of income growth of most households.

We are also very disturbed by the recent actions by both Federal secondary market agencies, the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). These agencies have announced that they will purchase adjustable rate mortgages with unlimited interest rate and monthly payment increases. Moreover, FNMA would allow an extraordinarily large amount of negative amortization—the loan balance, for example, could increase to 125 percent of the original loan amount. In addition, there is evidence that FNMA is considering abandoning the purchase of conventional fixed rate mortgages altogether.

The net effect of these actions could be not only to promote the very widespread use of adjustable rate mortgage devoid of borrower protections, but also to leave the FHA market as the primary source of fixed rate loans. But even this glimmer of hope is threatened, since the Reagan Administration has proposed to reduce the role of FHA. There are even reports that consideration is being given to shift FHA to an adjustable rate basis.

CRITICAL CONCERNS

The actions cited above pose a number of extremely serious dangers: the prospect of monthly payments increasing at a rate many times faster than the rate of increase in the household's income; the prospect of the outstanding balance on mortgage loan increasing faster than the value of the house, thereby eroding the homeowner's equity, and even causing the homeowner to owe more than the house is worth; the strong danger that the prospect of rapidly increasing monthly payments and/or rapid increases in the loan balance will cause lenders to become much more conservative and restrictive in their lending criteria, discriminating against borrowers whom they do not perceive to be highly upwardly mobile, and encouraging the resurgence of redlining of older urban neighborhoods which the lender may believe will appreciate less rapidly than average; the prospect that the use of more restrictive lending criteria will have a sharp discriminatory impact on minorities; for borrowers in older urban neighborhoods who do get loans, the danger of significantly increased default rates, thus inducing the spread of abandonment; the prospect of increased incentives to lenders to intensify their lending in gentrifying areas where property appreciation may be rapid, thus fueling displacment of existing residents; the prospect that persons shopping for a mortgage will be presented with a multitude of complex indexes to determine interest rate adjustments, thereby making comparison shopping extremely difficult; the prospect of the lender deciding to adjust the interest rate only when the index has gone up, creating a situation where the interest rate on the mortgage can only move up, and never move down; the prospect of very frequent adjustments in the interest rate and the monthly payment, creating difficulties in family budget planning; the prospect of inadequate and misleading disclosure materials for adjustable rate mortgages, creating a situation where consumers are unable to make informed decisions; the threat of the disappearance, or at least the very sharp curtailment of, the availability of fixed rate mortgages for those who need such mortgages.

We are especially concerned about the removal of all constraints on the potential rate of increase in the monthly payment. It is one thing to ask borrowers to bear some burden of the risk of interest rate fluctuations. However we say it is completely unfair to shift all of this risk to the borrower. The maximum level of risk which borrowers should be asked to bear must be rationally related to what borrowers, in general, can reasonably afford. The recent regulations fail this test miserably.

For example, an adjustable rate mortgage made in January 1978 with an initial interest rate of 9.15 percent and subsequent rate adjustments tied to the 6 month Treasury bill rate would have risen to 17.29 percent by January 1981. The monthly payment on a $50,000 mortgage would have increased from $408 to $702. This represents a 77.0 percent payment increase over a 3 year period in which the average wage for U.S. workers rose only 26.7 percent.

It must be further emphasized that in any given time period, large numbers of households have incomes which rise less rapidly than the average. Any policy to provide reasonable limitations on payment increases must recognize this fact, in order to assure that monthly payment increases are affordable by a significant majority of households.

GUIDELINES FOR LEGISLATION TO PROTECT MORTGAGE BORROWERS

We call upon the Congress to enact legislation to adopt reasonable borrower protections for adjustable rate mortgage and to assure that standard fixed rate mortgages continue to be available. In taking legislative actions, we urge that the following guidelines be followed:

Borrower protections for adjustable rate mortgages

(1) Monthly payments should not increase in any year at a rate greater than ⅔ of the rate of increase in the average U.S. workers' wage for the immediately preceding 12 months.

(2) Negative amortization should be prohibited or strictly limited.

(3) All adjustable rate mortgages should use the same index for rate adjustments.

(4) Any rate adjustments shall only be made at regular intervals which shall be no more frequently than once a year.

(5) Disclosure statements should follow a standardized format and provide (according to several economic scenarios prescribed by the regulators) several examples showing interest rate, monthly payment, and loan balance schedules for the full mortgage term.

Assuring continued availability of fixed-rate mortgages

(1) The basic FHA mortgage loan insurance and VA mortgage loan guarantee programs should remain on a fixed rate basis; they should be exempt from any Federal credit budget ceilings and thus be allowed to expand according to market demand.

(2) At least 50 percent of the conventional mortgages purchased by FNMA and the FHLMC should be fixed rate mortgages.

(3) Financial institutions should offer all qualified mortgage applicants of modest means and limited upward mobility the option of a fixed rate mortgage.

(4) The Federal regulatory agencies should monitor the availability of fixed rate mortgages to persons of modest means and limited upward mobility. If necessary to assure this availability, they should establish a requirement that a certain percentage of the mortgage loans made by each financial institution in any year shall be fixed rate mortgages.

Finally, it must be recognized that for large numbers of people, the type of legislation described above would not, by itself, make mortgage loans more affordable in today's high interest rate market. However, unless the legislation we propose is enacted, many people may find that they still can't obtain mortgages, even after interest rates fall, due to restrictive underwriting criteria caused by the prevalence of unrestricted adjustable rate mortgages.

ORGANIZATIONS ISSUING JOINT STATEMENT ON ADJUSTABLE RATE MORTGAGES

National Urban League;
National Urban Coalition;
National Committee Against Discrimination in Housing;
International Association of Machinists and Aerospace Workers;
Communications Workers of America;
Coalition of American Public Employees;
National Peoples Action;
National Association of Neighborhoods;
National Neighbors;
Association of Community Organizations for Reform Now (ACORN);
Center for Community Change;
Consumer Federation of America;
National Consumers League;
Public Interest Research Group;
National Rural Housing Coalition;
Rural Coalition;
Center for National Policy Review,
National Congress for Community Economic Development;
Member Churches of the Interfaith Center on Corporate Responsibility;
Housing Assistance Council;

Metropolitan Action Institute, Inc.;
Potomac Institute, Inc.;
Woodstock Institute; City of New York Commission on Human Rights;
New York City Housing and Community Development Coalition;
Bank of Bronx;
Bank of Brooklyn;
New York State Tenant and Neighborhood Coalition;
New York City Coalition Against Redlining;
Northwest Bronx Reinvestment Committee;
Greenpoint—Williamsburg Committee Against Redlining;
Pratt Institute Center for Community and Environmental Development (N.Y.);
Ohio Public Interest Campaign;
West Side Coalition of Concerned Citizens (Dayton);
Akron Coalition for Community Reinvestment;
People Power—Citizens Organization (Akron);
The Akron Chapter—Black Independent Party;
The Akron Public Interest Campaign;
East Akron Neighborhood Council;
North Akron Neighborhood Council;
NAACP—San Francisco;
League of United Latin American Citizens (State of California);
American GI Forum (California);
Sacramento Urban League;
Asian Law Center;
Oakland Committee for Community Reinvestment;
Oakland Citizens Committee for Urban Renewal (OCCUR);
Oakland Better Housing;
Ocean Park Community Organization (Ocean Park, California);
East St. Louis Neighborhood Development Corporation;
Metropolitan Washington Planning and Housing Association;
Massachusetts Urban Reinvestment Advisory Group;
Michigan Public Interest Research Group;
Minnesota Public Interest Research Group;
Working Group for Community Development Reform;
Rural America;
United Steelworkers of America;
New York Public Interest Research Group; and
Massachusetts Public Interest Research Group.

Senator LUGAR. Thank you very much.

Let me ask this question of both of you. Clearly your prepared statements—and these will be placed in the record in full, of course, and this is your summary testimony—both of you have stressed the fixed-rate aspect mortgages and the FHA role in doing that. Do you feel there are any circumstances under which an alternative mortgage instrument would be acceptable?

TAMPERING WITH FIXED-RATE MORTGAGES

Ms. CINCOTTA. I think that every time you tamper with it and make it different than the fixed rate, you're cutting out a lot of people who would have access to it.

The other thing is that by doing this, it will start to move the secondary market even more deeply into only buying variable-rate mortgages and HUD is supposed to be dealing with low- and moderate-income people, people who don't have access or whatever, not being able to have that one mortgage payment that constantly cuts out and hurts the constituency that you should be dealing with, that we feel you should.

Mr. FISHBEIN. I would concur with that and say that if we're talking about the marginal home buyer—and that may be distinct from the first-time home buyer whose projected income might increase substantially—an adjustable-rate mortgage loan is not going

to work to his other advantage. A marginal buyer will probably be unable to obtain one; it may not even be prudent for the buyer to do so. There are plenty of innovative programs that FHA could be getting into, but we'd like to see these new programs remain on a fixed-rate basis. For example, shared appreciation mortgages [SAM's], fixed-rate reversed annuity mortgages [RAM's], or any number of very creative but fixed-rate programs could be developed by FHA.

Senator LUGAR. I suspect that a majority, if not a unanimous number of the members of this subcommittee would agree with you that a fixed-rate, long-term mortgage would be ideal. I suppose one of the reasons for the formulation of this legislation is the recognition of some of the real crisis in the homebuilding and housing picture in America.

Let me just raise this question. I don't mean to be tedious, but another hypothetical situation—if given a choice for a potential either first-time or marginal home buyer is a home with an alternative mortgage instrument or no home at all, isn't it in the best interest of this potential consumer of housing to have the alternative mortgage instrument available?

Ms. CINCOTTA. If, by putting an alternative mortgage instrument in, you continually cut people out, you would be stopping your purpose. If your purpose is low and moderate and middle, the more you tamper with the fixed-term mortgage that are seen as affordable--you're not talking about upward mobile people necessarily. I think there is a difference between the first-time home buyer who could be somebody upward mobile and the one who isn't, but they are more likely to be able to afford the going interest rate. So that with limited dollars with the Federal Government, the more you tamper with it, the more you open it up to the high-income people and cut out the others. That is the problem I see with it.

Mr. FISHBEIN. I would just add to that that it seems to me to be very appropriate for Federal policy to address homeownership for those that the private market is not going to serve. The testimony on the adjustable-rate mortgage rules, when they were being developed by the regulatory agencies, suggested that these loans would not be going to the low- and moderate-income homebuyer. We believe that FHA should be serving the lower half of the housing market by encouraging the use of fixed-rate lending, at least for those who need the loans.

Senator LUGAR. Both of you in your experience have dealt with the core city housing for a long time. You address this in a way, Ms. Cincotta. Could you zero in further as to why you believe a very small percentage of FHA activity has been in the core cities of this country or, specifically in Chicago where you have served?

Ms. CINCOTTA. I think one is high interest rates have been a problem, but what seems to happen is if there's money available at low cost conventional, and the developer and the builders can sell their homes, there's not as much of a drain on the FHA. As soon as the crunch came in, it started to be used more and more to promote and sell developments that weren't moving, as opposed to housing people. So that the realtors all were moving more expensive property and moving the new construction.

I think that combination with the interest rates is dramatic and it has been in the last couple years.

Senator LUGAR. Do you have any further comments?

Mr. FISHBEIN. I don't have anything further to add to that.

Senator LUGAR. Earlier this morning, I suspect both of you were in the room at the time that I was discussing with the previous panel interest rates. As I recall, Mr. Hart mentioned that one reason why long-term mortgage rates specifically are likely to remain high for a period of time is that savings and loan institutions are equating the rate they charge with the rate they have to pay, and given the length of some of the CD's, the instruments with which they are obtaining money, there is a time frame here in which high mortgage rates are likely to be steady.

Now, at least if that analysis is true—and you may have a different interpretation of how you think mortgage rates are going to go—one of the reasons why this subcommittee is addressing this very difficult problem of FHA and what innovations in the circumstances FHA mortgages can have, is simply the recognition that we may have high mortgage rates for a period of time, both in the core cities as well as the suburbs.

I gather your testimony would still be that even if the rates are to remain high that FHA should stick with the long-term, fixed-rate mortgage, even though there may be fewer persons served. But I gather your testimony is the principle of this thing is so important that if the thin edge of the wedge of experimentation gets into this to get FHA and people into housing that that would be destructive. I don't want to characterize what you're saying unfairly, but could you respond again, given that context?

FORECLOSURES STARTING TO INCREASE

Ms. CINCOTTA. I think what I'm referring to is already seeing what's happening in the financing with the foreclosures starting to increase, California being the bellwether State because they started off with these renegotiable rates earlier. So if we move FHA so fast now into doing this without looking much closer at what is going to be the history of even the conventional market in going into this variable rate, I think that we could be getting toward a disaster, plus just by having the variable rate that can go up, the person who purchases the home is looked at differently. You have to have a higher income and/or the appearance that your income is going to go up and therefore just by virtue of that, that cuts more people off the market, rather than that it's going to stay at this rate and if you're a marginal worker, you will at least make that.

The other thing in dealing and talking about the savings and loans, the savings and loans came in and asked for all the adjustable-rate mortgages and said that this was going to be the answer to how they could lower interest rates. We have been following in Chicago and other areas steadily what is the difference between conventional and the adjustable-rate mortgages and it's one-quarter of 1 percent at the most or one-half of 1 percent, nothing more than that. Most of them are equal and most of them just went out of the fixed-rate market.

So that saying that by giving us this it will help, didn't work with them. We would support the all-saver bill being made a permanent bill with higher interest tax exemptions off the interest so that the S. & L. industry could have a steady flow of lower interest money if they would be able to put that all in housing and in long-range mortgages. At least, I think that would signal to them that housing is being taken seriously by the committee and that the S. & L.'s and conventional financing have to exist, and I think that would be important. I think we could deal with the conventional market and FHA wouldn't be in this plight.

Mr. FISHBEIN. I think we are all trying to get at the problem of high interest rates and we're just trying to design the vehicle that's going to be the most helpful in achieving that end. The question posed by this bill is really one of timing. None of us is sure what's going to be happening in the conventional market. We're still waiting for the dust to settle. We're not sure to what extent fixed-rate lending will remain an important part of the overall conventional market, and it seems to me that we should be deferring judgment on FHA until some time in the future, or at least until we have a better sense of which direction the conventional market is moving toward.

Now about the adjustable-rate mortgage, I agree with Ms. Cincotta, the instrument was being sold as a way of reducing interest rates because the borrower would be able to hedge against increases in inflation in the future. We haven't seen that happening.

Right now, the way ARM's are structured, most of the risk is borne by the borrower, very little by the lender, since they are usually unrestricted and lenders can raise monthly payments to almost any level. FHA certainly shouldn't be engaged in that kind of lending activity, particularly if its programs are designed to serve home buyers.

Senator LUGAR. You would suggest, then, that some of the questions that we're attempting to address in S. 1702 are more properly deferred to sometime in the future, as you say, until the dust settles on the whole prospect of fixed-rate mortgages? Could you offer any idea of how long a deferral you think would be appropriate?

Mr. FISHBEIN. I don't think any of us can really say although we are facing a crisis in housing in this country across the board it is most severe in low- and moderate-income neighborhoods in urban areas. We have to recognize that homeownership has been virtually shut down. Perhaps we should be exploring ways to subsidize homeownership although that's not a popular concept in some circles as a way of addressing the affordability issue in urban areas. The affordability of housing for low- and moderate-income families is not addressed by this bill and has yet to be addressed by other legislation before this subcommittee.

Ms. CINCOTTA. Another thing is like when you talk about increasing the limits on the mortgages, I wonder should FHA—you talk about four units for a $240,000 mortgage. Should FHA 203 even be giving that kind of mortgage, even at a lower rate where you're providing it for even the first-time home buyer? I can't buy that.

The other question, he asked how does it do for investors? People I know who are buying condominiums for investment are making

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out fine and are going to end up with the property. They don't pay anything right now between the tax breaks they get and everything else. So that the more we look at the limited resources, maybe one increase on the two units and a little higher on five or six, but when you get past that into three or four units, is that even a good use of money, especially if you're going to increase it or at least keep it what it is? I guess our concern is there's such limited resources and there's a larger group of people hurting besides low and moderate—it's into the lower middle—and what are we doing with these resources?

Senator LUGAR. Well, that's a very good question. I suppose you know the dilemma each one of us is going to face. Mr. Fishbein suggested that this legislation may not answer the problems of the price of housing—I make no representation that it would. We are going in a bipartisan way to limit Federal spending with a continuing resolution. The prospects for very substantial Federal subsidies, whether they be helpful to housing or not, are not going to occur, at least in the coming year.

Therefore, we are attempting to think creatively of those things that institutions that are now in place might do. That is the purpose of these questions. But I appreciate very much the very straightforward testimony you have both given from the perspective of consumers of housing and the neighborhoods you serve.

Do you have a further comment, Mr. Fishbein?

TIME BOMBS WAITING TO EXPLODE

Mr. FISHBEIN. In closing, let me state that it is our view that the new adjustable rate mortgages and the rollovers are time bombs waiting to explode. Lenders are playing with dynamite by issuing these types of mortgages. Given the past experience with FHA such as in the late 1960's with the massive foreclosures, I would think that FHA would be particularly careful about engaging in or insuring risky lending activity.

For example, I cited in my written testimony that in Buffalo where a savings bank up there was calling in rollover mortgages which it had made 5 years ago. While the bank was willing to negotiate these loans at slightly below market interest rates, borrowers would be paying about double the amount they were paying before. The bank's action created a spontaneous public demonstration; 900 homeowners outraged by the fact that their monthly payments were doubled and they were not able to afford to make these payments. I don't want to see FHA insuring that kind of activity and foreclosing on these people. Until we get a better fix on just what these mortgage instruments are going to mean for the average home buyer, I would urge you to be very careful and very circumspect in the changes you are proposing for FHA.

Senator LUGAR. Thank you. Do you have a final comment?

Ms. CINCOTTA. I guess my closing comment would be whatever FHA does is going to set the mold for what conventionals do and if FHA buys into the inflation syndrome through the Senate it's going to insure this is the way we're going to go for housing, and that's the way it's going to be. If FHA would just hang on for a

while, it might bring the others back into a line that we can deal with.

Senator LUGAR. I thank both of you on behalf of the subcommittee.

For the moment, the hearing will be recessed and we will return in about 5 minutes for our final panel. Thank you very much.

[Recess.]

Senator LUGAR. The hearing will come to order again.

The Chair would like to call the panel of Holt Blomgren, National Manufactured Housing Federation; Bill Weide, Fleetwood Enterprises, Inc., and Jim Shea, Fairmont Homes from Nappanee, Ind.

Gentlemen, thank you very much for coming to this hearing this morning. I would like to hear the testimony in the order that I introduced you. First of all, Mr. Holt Blomgren.

STATEMENT OF HOLT BLOMGREN, NATIONAL MANUFACTURED HOUSING FEDERATION

Mr. BLOMGREN. Thank you, Mr. Chairman. I'm pleased to appear before your committee in support of S. 1702.

I'm Holt Blomgren and I'm speaking today on behalf of the members of the National Manufactured Housing Federation, an organization of 27 State and regional associations who represent the great majority of the manufactured housing retailers and manufactured housing community owners and developers in the Nation, together with selected individual manufacturers. This federation is also a member of the Coordinating Council on Manufactured Housing Finance, a group of mobile home manufacturers, retailers and trade associations who constitute a major segment of the manufactured housing industry.

REMOVE CONSTRAINTS AGAINST FACTORY-CONSTRUCTED HOMES

With the current administration's emphasis on the elimination of unnecessary Federal programs, on balanced budgets, and on tax revision, a legitimate question is raised as to what extent, if any at all, the Federal Government should be involved in housing programs. We believe that there is a vital role which the Department of Housing and Urban Development should play in housing assistance. Yet, we also believe that HUD's role and the Government housing programs should be reexamined, streamlined, and revitalized in order to assist the housing industry to meet the needs of the public through the free enterprise system. We believe this can be done without massive direct subsidy programs and huge outlays of Federal funds. A major part of the answer to, and the solution of, our housing needs and problems will cost no money and require no direct subsidies. It can be achieved by merely longstanding constraints against factory constructed homes. Constraint removal carries no price tag and rests solely on the principle of "equity through parity."

It is in this context that the federation is pleased to add its endorsement favoring enactment of S. 1702, the FHA Revitalization Act of 1981, and, in particular, the language contained in title V which amends section 203 of the National Housing Act, expanding the eligibility criteria to include mortgages "secured by a dwell-

ing which satisfies standards prescribed under the National Manufacturing Housing Construction and Safety Standards Act of 1974," and "which is affixed to a site-built permanent foundation."

HUD's current policy concerning acceptability of HUD-code manufactured homes for title II, 203(b) financing, is stated somewhat obscurely in two notices. The first HUD notice, dated August 28, 1980, concerning existing construction, states that: "Permanently sited double-wide mobile homes and manufactured housing units will be treated as any other existing property when appraising for mortgage insurance purposes."

Existing housing less than 1 year old is eligible only for a lower loan-to-value ratio of 90 percent, as opposed to a limitation of 95 to 97 percent for dwellings more than 1 year old.

The second HUD notice, dated January 12, 1981, concerning "proposed construction" repeats the basic policy announced in August of 1980 that the "method of construction, that is mobile home units, will not automatically disqualify such units for title II eligibility."

However, this notice contradicts the stated basic policy by requiring, inter alia, that "such property involving a qualifying mobile home unit shall comply with the HUD Minimum Property Standards," or comply with a HUD Structural Engineering Bulletin. In addition, this notice established acceptance requirements for properties involving multisection homes [purchased prior to installation] which go beyond the requirements of the HUD Minimum Property Standards.

However, if the manufactured home is not yet on its foundation system on the owner's lot it is not eligible for title II financing unless it was constructed to the HUD MPS. In other words, the HUD code is deemed inadequate for qualification if the home is not yet on its foundation system.

Now it seems to us, Mr. Chairman, that this policy really ignores the reality of the entire marketing and distribution system for this industry. The fact is, of course, that manufactured homes are sold by retailers from lot inventories and thus typically purchased and financed prior to being installed on the ground. The policy then effectively bars manufactured homes from title II financing under those circumstances.

Another facet of the policy is that to qualify for title II financing the manufactured home must be classified as real estate. It's been our experience in the industry that these policy notices are both confusing and unrealistic. For example, it s confusing for HUD to enunciate a policy which makes an arbitrary distinction, for financing purposes, between two identical homes, one of which is installed on its site and another which will be installed on its site in a matter of a few hours. It is also unrealistic, in our judgment, to specify more favorable terms, let's say 95 to 97 percent, financing for homes more than 1 year old.

The federation, therefore, welcomes the language contained in title V on this matter and would add the recommendation that the HUD Secretary be urged to adopt a conforming policy which eliminates the present penalty imposed on homes less than 1 year old, and which is not dependent upon the varying requirements of

State laws which purport to define what is, and what is not, "real" property.

The enactment of legislation containing this language is, moreover, entirely consistent with the current policy of the Federal National Mortgage Association which, effective in August of this year, in a move aimed at making affordable housing more readily available and easy to finance, offered to purchase home mortgages on HUD-code manufactured homes nationwide. The federation agrees completely with this realistic policy.

INSURANCE ELIGIBILITY

With respect to the adequacy of the HUD Manufactured Housing Construction Standards, in insuring the structural integrity and durability of manufactured homes, examination of various authoritative comparative analyses of the HUD code and the HUD MPS, or other so-called voluntary codes, such as the BOCA One and Two Family Dwelling Code, reveal virtually no substantive differences which are relevant to the health or life safety of residents. Cited differences in such categories as hallway widths, ceiling heights, cabinetry specifications, quality of interior finishes, and so forth, other than items concerning health or safety, are, in our judgment, properly a matter of fee appraisal for determination of the market value of the home. Determination, then, of the risk-worthiness of a home for FHA insurance purposes should not depend upon whether the home was constructed to the HUD code, MPS, BOCA, or some other generally accepted voluntary code. The function common to all such codes should be to assure that the structure satisfies health and safety criteria. Such codes are not properly a basis for judgments concerning a home's market value or its eligibility for FHA insurance.

While fully supporting the amendments in title V as proposed in S. 1702, we do bring to the committee's attention the essentiality of HUD's continuing the title I manufactured housing program which, in the best tradition of this administration's concern for economy and efficiency in administration, and reliance upon the private sector for economic intiative, has been, in our judgment, a model of success.

Its coinsurance features with private lenders and its policy of delegated processing have placed upon FHA-approved title I lenders the primary responsibility for determining the credit worthiness of applicants. These features have made possible simple procedures that operate smoothly, with a minimum of Government interference and redtape. The eligibility of FHA title I insured loans for secondary market operations has complemented the program's features and has filled, in a practical way, a need for loan insurance not adequately provided for by the private sector. Obviously, the absence of the FHA title I program under these circumstances, in our judgment, would have the most serious effect on the capability of low-income families to finance the purchase of a manufactured home on favorable terms.

We would urge, therefore, that this committee recommend to the HUD Secretary that the title I program be retained as an essential and practical mechanism for assuring the capability of financing

sources for both homes to be sited on rented ground, or under the title I combination loan program, on private lots.

The federation recommends that the committee also urge the HUD Secretary to amend the existing FHA eligibility criteria for loans made for the purchase of used manufactured homes. The current HUD regulation limits title I loans on used homes to those previously financed under this program. It is our view that whereas this restriction may have been appropriate prior to the adoption of the HUD standards in 1976, during years when multiple secondary moves were common, this restriction is no longer needed nor appropriate today. A simple requirement that the used home bear a HUD certification label, coupled with careful selection by FHA field offices of competent members of the FHA fee appraiser panel, should provide sufficient assurances to FHA that estimated market values of used homes are reasonable and equitable for all parties, without the added constraint now mandated by HUD regulation.

THREAT OF SEVERE SHORTAGE OF FUNDS

Concerning the applicability to manufactured homes of adjustable rate loan and credit sale instruments, we do wish to bring to the committee's attention that equally important to availability of 203(b) financing to manufactured housing purchases, is action designed to avert the threat of a severe shortage of funds for the financing of manufactured homes which can result if innovative finance programs such as adjustable rate loan and credit sale instruments of the type currently being developed for traditional single family housing are not concurrently available to the buyers of the factory-constructed home. These innovative programs should apply whether the home is classified as real or personal property, or whether the credit transaction be a direct loan or a credit sale. This potential problem can be solved by legislation which would preempt State laws or regulations which restrict or prohibit the use of such adjustable rate instruments for these purposes. We do recommend that this committee support corrective legislation of this type.

Mr. Chairman, with respect to other provisions of S. 1702, we defer to the testimony being presented by Mr. Weide on behalf of the Coordinating Council for Manufactured Housing Finance and Western Manufactured Housing Institute. In general, the federation believes that this suggested legislation addresses in a realistic manner the crux of today's housing problem: Too few homes available at an affordable price on financing terms which are acceptable to the home buyer of modest income. The manufactured housing industry stands ready to play an expanded role in permitting the achievement of national housing objectives, once the constraints I have referred to in my testimony have been removed.

Thank you, Mr. Chairman, for this opportunity to make our views known.

[Complete statement follows:]

STATEMENT OF H. E. BLOMGREN, PRESIDENT, NATIONAL HOUSING FEDERATION

Mr. Chairman, I am pleased to appear before the Senate Subcommittee on Housing and Urban Affairs in support of S. 1702, the "FHA Revitalization Act of 1981."

I speak on behalf of the members of the National Manufactured Housing Federation, an organization of 27 state and regional associations who represent the majority of the manufactured housing retailers and manufactured housing community owners and developers in the nation, together with selected individual manufacturers. This Federation is also a member of the Coordinating Council on Manufactured Housing Finance, a group of mobile home manufacturers, retailers and trade associations who constitute a major segment of the manufactured housing industry.

With the current administration's emphasis on the elimination of unnecessary federal programs, on balanced budgets, and on tax revision, a legitimate question is raised as to what extent, if any at all, the federal government should be involved in housing programs. We believe that there is a vital role which the Department of Housing and Urban Affairs should play in housing assistance. Yet, we also believe that HUD's role and the government housing programs should be re-examined, streamlined, and revitalized in order to assist the housing industy to meet the needs of the public through the free enterprise system. We believe this can be done without massive direct subsidy programs and huge outlays of federal funds. A major part of the answer to, and the solution of, our housing needs and problems will cost no money and require no direct subsidies. It can be achieved by merely removing long standing constraints against factory constructed homes. Constraint-removal carries no price tag and rests solely on the principle of "equity through parity". That is, homes of comparable size and quality should enjoy equal treatment in government programs and policies. Since the manufactured home is now, and has been since 1976, the only residential dwelling built to a mandatory federal construction code, the old "trailer house" issues concerning its quality or safety are simply not relevant. The advocacy of constraint-removal to achieve parity requires only recognition of the industry's current "state of the art" and an application of its capability to produce and market homes in single or multi-sections in a variety of sizes, models, designs and prices from a range of $12,000 to $60,000. It is, thus, no longer useful or realistic to base housing programs or policies on outdated concepts, or factory-constructed and non-factory constructed residential dwellings. In simplest terms, we submit that "comparable housing should be treated comparably".

Although the demand grows daily for the quality and affordable housing that our industry is best qualified to provide, it remains difficult throughout most of the nation to finance the purchase. The cause is traceable to a number of factors which include the outdated perception of some lenders that the factory-constructed home is an inferior product, purchased by buyers of questionable risk-worthiness. Complicating the financing process is the fact that the manufactured home, if placed on rented ground, is considered in some areas as "personal" property, but if placed on a foundation system on the owner's private land may be consider as "real" property. As a matter of current practice, about half of such homes are placed on private lots. Even those placed on rented land, are seldom moved again. In any case, the inability of the buyer of modest income to find a financing source on reasonable terms remains a most serious and widespread problem.

At a time when the rising costs of housing construction are coinciding with high interest rates with a consequent deficit of affordable and quality single-family homes in the nation's housing inventory, the manufactured housing industry offers a unique capability of rapidly producing quality homes that families of low income can afford. Such capability is not limited by production capacity or technical competence, but rather by the ability of the home buyer to finance the purchase on terms which the family income can sustain.

In the current economic climate, the availability of credit on reasonable terms is more than ever the dominant determinant as to whether a needed home can be purchased. Credit availability is a perishable commodity, highly vulnerable to vicissitudes of the money market. Harmful developments can and do discourage investment in manufactured housing financing. Yet, favorable developments, such as the advent of S. 1702, can encourage investment, thus stimulating the availability of housing loans on favorable terms not otherwise available.

TITLE V.—S. 1702

It is in this context that the Federation is pleased to add its endorsement favoring enactment of S. 1702, the "FHA Revitalization act of 1981", and, in particular, the language contained in Title V which amends Section 203 of the National Housing Act, expanding the eligibility criteria to include mortgages "secured by a dwelling which satisfies standards prescribed under the National Manufactured Housing Construction and Safety Standards Act of 1974", and "which is affixed to a site-built permanent foundation."

HUD CURRENT POLICY

HUD's current policy concerning acceptability of HUD-code manufactured homes for Title II, 203 (b) financing, is stated somewhat obscurely in two "Notices". The first HUD Notice, dated August 28, 1980, concerning existing construction, states that:

"Permanently sited double-wide mobile homes and manufactured housing units will be treated as any other existing property when appraising for mortgage insurance purposes." In other words, such units are not automatically disqualified for Title II eligibility.

The policy does, however, expressly limit such eligibility in these crucial ways:

(a) Single section homes are not eligible;

(b) The home must be permanently located on its site;

(c) The home and lot must be classified as real estate.

The question thus remaining is exactly what constitutes "existing housing". If "existing housing" means housing already constructed on the ground, the policy mandates that the (multi-section) home be permanently sited. However, for mortgagors to obtain the maximum Title II mortgage amount, the home must have been on the site for more than one year preceding the date of the application for mortgage insurance. (24 CFR 203.18(a)(2). Existing housing less than one year old is eligible only for a lower loan-to-value ratio of 90 percent, as opposed to a limitation of 95 percent to 97 percent for dwellings more than one year old. (24 CFR 203.18(a)).

The second HUD "Notice", dated Jaunary 12, 1981 concerning "proposed" construction repeats the basic policy announced in August of 1980 that the "method of construction, i.e. mobile home untis, will not automatically disquality such units for Title II eligibility."

However, this Notice contradicts the stated basic policy by requiring, inter alia, that "such property involving a qualifying mobile home unit shall comply with the HUD Minimum Property Standards", or comply with a HUD Structural Engineering Bulletin. In addition, this Notice established acceptance requirements for properties involving multi-section homes (purchased prior to installation) which go beyond the requirements of the HUD Minimum Property Standards. (Items 6, 7a, and 8 of the cited Notice).

In summary, the August HUD Notice states that once multi-section homes are permanently sited, they can qualify for Title II financing without meeting the arbitrary criteria of the HUD MPS, but only in those states which classify manufactured homes as real property.

It has been our experience that these Policy Notices are both confusing and unrealistic. For example, it is confusing for HUD to enunciate a policy that makes an arbitrary distinction, for financing purposes, between two identical homes, one of which is installed on its site, and another which will be installed on its site in a matter of a few hours. It is also unrealistic in our judgment, to specify more favorable terms (95 percent to 97 percent) financing for homes more than one year old.

The Federation, therefore, welcomes the language contained in Title V on this matter, and would add the recommendation that the HUD Secretary be urged to adopt a conforming policy which eliminates the present penalty imposed on homes less than one year old, and which is not dependent upon the varying requirements of state laws which purport to define what is, and what is not, "real" property.

The enactment of legislation this language is, moreover, entirely consistent with the current policy of the Federal National Mortgage Association which, effective in August, 1981, in a move aimed at making affordable housing more readily available and easy to finance, offered to purchase home mortgages on HUD-code manufactured homes, nation-wide. In purchasing home mortgages, FNMA applies the same borrower credit and property guidelines applicable to site-assembled homes, to include mortgage terms as long as 30 years and downpayments as low as 5 percent. The basic FNMA requirement is simply that the transaction involve a land and home sold as a package and financed in a single real estate mortgage. There is no requirement that such homes meet HUD MPS, nor that manufacturers submit model plans to FNMA in advance to assure acceptability. The Federation agrees completely with this realistic policy.

CODE CONSIDERATIONS

With respect to the adequacy of the HUD Manufactured Housing Construction Standards in insuring the structural integrity and durability of manufactured homes, examination of various authoritative comparative analyses of the HUD code and the HUD MPS, or other so-called voluntary codes, such as the BOCA One and

Two Family Dwelling Code, reveal virtually no substantive differences which are relevant to the health or life-safety of residents. Cited differences in such categories as hallway widths, ceiling heights, cabinetry specifications, quality of interior finishes, etc., other than items concerning health or safety are, in our judgment, properly a matter of fee appraisal for determination of the market value of the home. Determination, then of the risk-worthiness of a home for FHA insurance purposes should not depend upon whether the home was constructed to the HUD, MPS, BOCA or some other generally accepted voluntary code. The function common to all such codes should be to assure that the structure satisfies health and safety criteria. Such codes are not properly a basis for judgments concerning a home's market value or its eligibility for FHA insurance.

TITLE I FINANCING

While fully supporting the amendments in Title V as proposed in S. 1702, we bring to the Committee's attention the essentiality of HUD's continuing the Title I Manufactured Housing Program which, in the best tradition of this Administration's concern for economy and efficiency in administration, and reliance upon the private sector for economic initiative, has been a model of success.

Its coinsurance features with private lenders and its policy of delegated processing have placed upon FHA-approved Title I lenders the primary responsibility for determining the credit-worthiness of applicants. These features have made possible simple procedures that operate smoothly, with a minimum of government interference and red tape. The eligibility of GHA Title I insured loans for secondary market operations has complemented the program's features and has filled, in a practical way, a need for loan insurance not adequately provided for by the private sector. Unlike traditional site-constructed home mortgage financing, there is no private mortgage insurance program now available for the maufactured home, only, without land. Obviously, the absence of the FHA Title I program under these circumstances would have the most serious effect on the capability of low income families to finance the purchase of a manufactured home on favorable terms.

We would urge, therefore, that this Committee recommend to the the HUD Secretary that the Title I Program be retained as an essential and practical mechanism for assuring the capability of financing sources for both homes to be sited on rented ground, or under the Title I Combination Loan Program, on private lots.

USED HOMES

The Federation recommends that the Committee urge the HUD Secretary to amend the existing GHA eligibility criteria for loans made for the purchase of used manufactured homes. The current regulation (24 CFR, 201.510 (b)) limits Title I loans on used homes to those previously financed under this program. It is our view that whereas this restriction may have been appropriate prior to the adoption of the HUD Standards in 1976, during years when multiple secondary moves were common, this restriction is no longer needed nor appropriate. A requirement that the used home bear a HUD certification label, coupled with careful selection by FHA Field Offices of competent members of the FHA fee appraiser panel, should provide sufficient assurances to FHA that estimated market values of used homes are reasonable and equitable for all parties, without the added constraint now mandated by HUD regulation. Adoption of this modification by the HUD Secretary should expand measurably the availability of quality, used manufactured homes for low income buyers.

CREATIVE OR INNOVATIVE FINANCING

While the matter of the applicability to manufactured homes of adjustable rate loan and credit sale instruments may not be germane to the provisions of S. 1702, we do wish to bring to the Committee's attention that equally important to the availability of 203 (b) financing to manufactured housing purchases, is action designed to avert the threat of a severe shortage of funds for the financing of manufactured homes which can result if innovative finance programs (adjustable rate loan and credit sale instruments) of the type currently being developed for traditional single-family housing are not concurrently available to the buyers of the factory-constructed home. These innovative programs should apply whether the home is classified as real or personal property, or whether the credit transaction be a direct loan or a credit sale. This potential problem can be solved by legislation which would preempt state laws or regulations which restrict or prohibit the use of such adjustable rate instruments for these purposes. We do recommend that this Committee support corrective legislation of this type.

OTHER PROVISIONS

Mr. Chairman, with respect to other provisions of S. 1702, we defer to the testimony being, presented by Mr. Weide on behalf of the Coordinating Council for Manufactured Housing Finance and the Western Manufactured Housing Institute. In general, the Federation believes that this suggested legislation addresses in a realistic manner the crux of today's national housing problem: Too few homes available at an affordable price on financing terms which are acceptable to the home buyer of modest income. The manufactured housing industry stands ready to play an expanded role in permitting the achievement of national housing objectives, once the constraints I have referred to in my testimony have been removed.

We view S. 1702 as a genuinely favorable development both timely and realistic.

We would only hope that its eventual passage, either in its present form, or in amended form, provide some assurance that the authorities granted to the Department of HUD be coupled with direction that it is the intent of the Congress that such provisions be promptly implemented, rather than substantially delayed as in the past.

Thank you, Mr. Chairman, for this opportunity to make our views known.

Senator LUGAR. Thank you, Mr. Blomgren. The statements of each of you gentlemen will be placed in the record in full, and at this time I'd like to call upon Mr. William Weide for his comments. If you can summarize your testimony it would be helpful and, likewise, Mr. Shea, and then we'll proceed with the questions.

STATEMENT OF WILLIAM WEIDE, FLEETWOOD ENTERPRISES, INC., RIVERSIDE CALIF., ACCOMPANIED BY WILLIAM LEAR, GENERAL COUNSEL OF FLEETWOOD ENTERPRISES, INC. AND CO-CHAIRMAN OF THE COORDINATING COUNCIL ON MANUFACTURED HOUSING FINANCE; AND HARVEY WEINER, COUNSEL

Mr. WEIDE. Thank you, Mr. Chairman. My name is William W. Weide, and I am president and chief operating officer of Fleetwood Enterprises, Inc. of Riverside, Calif.

Fleetwood is one of the Nation's largest producers of manufactured housing, operating 23 plants throughout the United States and Canada. In addition to representing my own company, I am before you today to address the subcommittee on behalf of the Western Manufactured Housing Institute and the Coordinating Council on Manufactured Housing Finance. Accompanying me is Mr. William Lear, general counsel of Fleetwood and co-chairman of the coordinating council. Also with me today is Mr. Harvey Weiner, who serves as Washington counsel for the coordinating council. WMHI is also a member of the coordinating council which is a national group of manufactured housing retailers, lenders, manufacturers and trade associations that have organized for the purpose of obtaining improved Federal and secondary market finance programs for manufactured housing. I will be using the name "coordinating council" in my testimony to include both WMHI and Fleetwood.

I have previously submitted a written statement to the subcommittee and with your permission, Mr. Chairman, I would like to summarize those remarks at this time.

I am delighted to have this opportunity to comment on S. 1702, the FHA Revitalization Act of 1981, and its related issues. I believe that the proposals embodied in that bill and others which you raised in your Congressional Record statement accompanying the

bill, can have an enormous beneficial impact on affordable housing, and particularly the manufactured housing industry.

AFFORDABLE HOMEOWNERSHIP WITH MANUFACTURED HOMES

As you know, Mr. Chairman, manufactured housing has reached a prominent position in our Nation's shelter market, due in large part to the efforts of this subcommittee, for which we in the industry are sincerely grateful. Manufactured home sales account for approximately one-fourth of all new home sales in the country, and in many areas, constitute the only form of affordable homeownership. Today, manufactured housing constitutes the vast majority of all homes under $50,000. More importantly, manufactured housing has become a viable answer to the housing needs of many families of modest income, particularly first-time homebuyers and the elderly.

Congress has increasingly recognized the benefits of manufactured housing as demonstrated by the enactment of legislation in the Housing and Community Development Act in 1974 which provided that all manufactured homes would conform to a single construction and safety code. Since that landmark legislation, Congress has steadily expanded the range of loan insurance and subsidy programs available for manufactured housing.

We recognize, Mr. Chairman, that much of that important legislation would not have come to pass without your help and leadership.

The coordinating council believes that S. 1702 can be very significant for manufactured housing and will make affordable homeownership available to more families in a greater variety of improved and innovative settings. I would like to comment more specifically about that in a moment and suggest, in a few areas, how that objective can perhaps be more effectively reached.

First, I would like to offer a general comment on the redirection you have proposed for FHA. Mr. Chairman, we strongly support your view that FHA should be returned to its historic role of leader and innovator in providing affordable home financing, particularly for purchasers who might not otherwise qualify for conventional loans. Today, home finance is in a crisis state with conventional rates averaging over 18 percent. Increasing numbers of families are locked out of the conventional market. Now, more than ever before, is the time for a revitalized FHA. As the ranks of the marginally qualified homebuyers swell in the 1980's, FHA must be reawakened and resume its former leadership position. S. 1702 is a laudatory first attempt to put FHA back on the cutting edge of home financing. Of course, Mr. Chairman, we feel it is also imperative that FHA continue in its fundamental responsibility of providing a safety net for the broader housing sector.

At this time, I would like to address a few of the key provisions in S. 1702 which more directly affect manufactured housing. In my written statement you will find more detailed comments on these and other provisions of S. 1702 as well as additional subjects raised in your floor statement. Accordingly, Mr. Chairman, I will lead off with the most important provision of S. 1702 from our standpoint, section 501.

PROGRAM FOR FINANCING MANUFACTURED HOUSING

This provision would authorize FHA single family mortgage insurance under the section 203(b) program for financing manufactured housing in all real property home and lot transactions so long as the home meets the HUD manufactured housing code and is permanently affixed to a foundation. Opening 203(b) to new single and double-section HUD-code manufactured homes will be a major step forward for FHA in providing greater and more flexible affordable housing opportunities. While HUD has taken administrative steps to alleviate this situation, which we commend, we believe that this legislation is extremely useful because it will make clear, once and for all, that manufactured homes are intended by Congress to be eligible for 203(b) financing. In addition, title II financing will enable the marketplace, rather than FHA, to determine the appraised value and the term of financing. This change will also extend parity to manufactured housing with site-built homes and conform to the recent decision by FNMA to accept HUD-code manufactured homes on lots in their single-family mortgage purchase programs.

This is not to say, Mr. Chairman, that the 203(b) program can supplant the FHA title I manufactured home loan program. It cannot and should not. The title I program has been an efficient program for both FHA and lenders. In addition, since manufactured home and lot combinations are not classified as real property in many States, and even where real property may not be placed on permanent foundations, they may not be eligible for 203(b) real property mortgage insurance.

For this reason, and since a majority of manufactured homes continue to be financed as personal property, it is critical that section 101 of the bill, authorizing FHA experimental finance authority, should also be extended to title I insured loans. Since a majority of manufactured homes are not financed with real property as mortgages, adjustable rate lending flexibility needs to be available to that segment of the market as well. Otherwise, manufactured housing consumers could conceivably face a shutoff of funds should lenders turn away from fixed-rate instruments. As conventional site-built home financing instruments change, manufactured home financing must also have those tools to remain competitive.

The coordinating council also recommends an amendment to S. 1702 which would expressly authorize title I financing for existing manufactured homes. As you know, Mr. Chairman, today's manufactured homes bear little resemblance to the homes which predominated when the title I program was first enacted. The longevity and popularity of today's product has created a growing and important resale market in manufactured housing. This, in turn, has the potential for generating more affordable housing opportunities for families of limited means. With title I financing for existing manufactured homes, these opportunities could be available at better terms and rates to greater numbers of households. A more viable resale market would have the added benefit of stabilizing the market for new manufactured housing as well.

Title III of the bill grants FHA greater authority to help finance new condominium units, and at this particular time I might just pause to say that we are in the process of building a 600-unit condominium development in Florida on the west coast and we are having fixed-rate mortgages of 25 and 30 years, but we need to take a better look at condominiums as the answer to the manufactured housing ability to supply housing to those who need it.

FHA section 234 condominium financing, presently applies only to manufactured homes which meet conventional HUD minimum property standards. In keeping with the amendment your bill proposes for section 203(b), we recommend that both sections 234 and 213 of the National Housing Act also be amended to permit manufactured home financing for homes built to the HUD construction code.

Finally, Mr. Chairman, I noted in your statement accompanying the introduction of S. 1702, your efforts to free up private pension funds for secondary market housing investment. We agree that pension funds with their enormous resources may share the future of housing finance. We have noted S. 1678, a bill you cosponsored with Senator Hatch, proposing certain amendments to ERISA to stimulate pension investment in home lending. Since the bill, as presently written, would not apply to most manufactured home loans, the coordinating council has suggested certain amendments, explained in greater detail in my written statement, which would include manufactured housing loans for ERISA eligibility.

Mr. Chairman, this concludes my remarks and I want to thank you for your dedication to affordable housing and in particular to manufactured housing. Thank you.

[Complete statement follows:]

Statement of

William W. Weide
President and Chief Operating Officer
Fleetwood Enterprises, Inc.
Riverside, California

for

Fleetwood Enterprises, Inc.

Western Manufactured Housing Institute

and

Coordinating Council on Manufactured
Housing Finance

Mr. Chairman and members of the Subcommittee, my name is William W. Weide. I am President and Chief Operating Officer of Fleetwood Enterprises, Inc. of Riverside, California.

I am accompanied today by the Vice President and General Counsel of my company, William Lear and also by Harvey Weiner, who is Washington Counsel to the Coordinating Council on Manufactured Housing Finance. Fleetwood is one of the nation's largest producers of manufactured housing, with 23 manufacturing plants currently in operation in 10 states and one Canadian province. During our most recently completed fiscal year which ended last April, we produced manufactured homes with a wholesale value of approximately $206 million. In addtion to my own company, my testimony today is provided on behalf of two industry trade groups. One is the Western Manufactured Housing Institute (WMHI), of which Fleetwood is a member. WMHI is the trade association of manufacturers and suppliers in our industry in the 13 Western states. WMHI consists of 130 suppliers and 28 manufactures representing the production of approximately 65 to 70 percent of the manufactured homes shipped in the Western states. I am also here today to testify on behalf of the Coordinating Council on Manufacutured Housing Finance, of which both Fleetwood and WMHI are members. The Coordinating Council, of which Bill Lear of Fleetwood is a founder and serves as co-chairman, is a group of manufacturers, retailers and manufactured housing industry trade associations which have joined together to obtain improvements in both Federal and conventional manufactured home finance and secondary market

programs. Its members include the National Manufactured Housing Federation, a group of some 27 state and regional associations of retailers and manufacturers, whose President, Holt Blomgrem, is also appearing before you today; The Texas Manufactured Housing Association, a state-wide organization with over 600 members; the Oklahoma Manufactured Housing Association; and individual corperate members including Chief Industries, Inc.; Golden West Homes; Kanfman and Broad Home Systems, Inc.; Redman Mobile Homes, Inc.; Siegel Mobile Home Group; and Silvercrest Industries, Inc. For purposes of this joint statement, I will use the name Coordinating Council to include the positions of Fleetwood Enterprises, WMHI, and the Coordinating Council itself.

Mr Chairman, my comments today will be divided into three sections. First, I would like to summarize the Coordinating Council's position and offer a brief overview of the bill. Second, I will offer some comments and suggestions on the specific provisions contained within S.1702, and third, I will offer some thoughts on issues, not directly contained within S.1702, but which are of great importance to Fleetwood and the two associations on whose behalf I appear today.

I. Overview

It is a pleasure for me to address you on the important issue of the broadening of the powers (or "revitalization") of the Federal Housing Administration (FHA). Although our homes

are generally priced lower (and therefore are generally more "affordable") than comparable site-built homes, they are among the most expensive purchases ever made by most of the people who buy and reside in them. The health of the financial institutions which provide funds to the purchasers of our homes and the authority and ability of these organizations to provide financing which is satisfactory to our buyers, yet will assure the institutions a reasonable profit, is of vital interest to our industry. We have watched with great interest the debate on the legislation which was recently introduced by the distinguished Chairman of the Banking, Housing and Urban Affairs Committee, Senator Garn, for the purpose of revitalizing the thrift industry. We believe that action in this area is extremely important to the financial health of the thrifts and of the housing industry generally.

Similarly, we strongly support efforts such as that of your proposed legislation, S.1702, Mr. Chairman, to reexamine and expand the resources of the FHA, so that we can be reasonably assured that it will continue in good health and will be able to provide much-needed financing to qualified home purchasers. As you so aptly stated when introducing this bill, Mr. Chairman, no one needs to be told of the problems currently faced in this country in the area of housing. There are many, but in the final analysis, they revolve around the availability and the cost of financing. We believe S.1702 provides a good start on attacking many of these problems.

While we support this legislation in its entirety and believe its enactment will help provide further vitality to the FHA, our major interest is in Title V of the bill. Section 501 would establish, on a permanent basis, that manufactured housing built in conformance to the National Manufactured Home Construction and Safety Standards Act of 1974 (42 U.S.C. §5401 et seq)("HUD Code") and affixed to a permanent foundation would be eligible for financing under Section 203(b) of the National Housing Act. Such financing would be in addition to the Title I combination land and home program, and would be on the same terms and conditions as any other form of single-family housing. We believe that this is a sound and important step which is clearly justified by the quality of the homes and we urge enactment of this provision. It has long perplexed us that used manufactured homes have been eligible for Section 203(b) financing while new manufactured homes, though built in the most modern fashion, have not been. This has been an anomaly of the law which we believe has been without justification. While HUD has taken administrative steps to alleviate this situation, which we commend, we believe that this legislation is extremely useful because it will make clear, once and for all, that manufactured homes are intended by Congress to be eligible for Section 203(b) financing.

In addition to my discussion of Title V of S.1702, my other comments can be summarized briefly as follows:

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- We believe that the innovative experimental finance and short-term mortgage and mortgage-backed securities programs that you propose are crucial in today's volatile finance market. We propose, however, that this experimental authority be extended to include Title I insured manufactured home loans. The same market forces that necessitate the implementation of such adjustable rate finance provisions for site-built Title II insured housing, also necessitate similar provisions for Title I insured manufactured home loans.

- We strongly endorse your efforts to expand the section 234 condominium finance program. However, we recommend that this provision be amended to expressly authorize Section 234 financing for manufactured home condominium units and Section 213 financing for cooperative housing units constructed according to the provisions of the HUD Code. This amendment would be consistent with the provisions of Section 501 of this bill which authorizes Section 203(b) financing for manufactured homes constructed to the HUD Code.

- We support increased FHA insurance authority for homes on leased land. We propose that this

authority be extended to the Title I insured combination manufactured home and land loan program.

- We also urge the Subcommittee to encourage HUD to act more expeditiously in implementing new legislative authority. Delays of a year or more unfortunately are quite common.

- In addition to our FHA comments, we offer a comment with regard to another bill introduced by the Chairman (S.1678). We propose that authority be granted to private pension plans to invest in both direct and indirect manufactured home loan paper and pools.

- We urge the Subcommittee to extend present authority for negotiated interest rates to the Title I manufactured home loan insurance program. We believe that the competitive forces in the marketplace will serve to regulate interest rates more effectively than will the artificial imposition by FHA of such rate ceilings.

- Finally Mr. Chairman, we urge the Subcommittee to consider a provision to expressly authorize FHA

Title I insurance of existing manufactured homes. Current regulatory authority is limited to homes that have been previously FHA financed. There is a large stock of existing manufactured housing, and steps must be taken to provide financing that will make this housing more affordable.

Manufacturing Housing

Before I proceed further, I would like to provide you with an overview of the manufactured housing industry. I believe it is extremely important that the Subcommittee understand the prominent position that manufactured housing occupies in the current housing market. I am using the terms "manufactured housing" or "manufactured homes" to refer to those homes built to the standards of the HUD Code. As you will recall, the product name was changed from "mobile home" to "manufactured home" by Congress in the Housing and Community Development Act of 1980 (P.L. 96-399).

During 1980, over 221,000 new manufactured homes were sold in the United States. These homes accounted for approximately 23% of all new single-family home sales. In 1981, as housing sales have declined, manufactured housing shipments have increased to some extent, especially of those homes in the lower price ranges. Presumably this is because, in these days of very high interest rates, these homes provide the only form of

affordable home ownership for many people. It should come as no surprise that manufactured housing today comprises over 82% of all homes sold for less than $40,000 and the vast majority of all homes under $50,000.

Congress has recognized the importance of manufactured housing on numerous occasions in recent years. This Subcommittee and its counterpart in the House of Representatives have repeatedly taken the lead in expanding the range of finance programs available to potential manufactured home owners through the programs of the FHA, the Veterans Administration (VA), the Government National Mortgage Association (GNMA) and most recently, the Federal National Mortgage Association (FNMA). It is our hope that, in due course, authority similar to that granted to FNMA will be provided by Congress to the Federal Home Loan Mortgage Corporation. Loan terms under these programs and under conventional finance programs can now extend to up to 30 years, and in certain isolated cases of conventional programs, to as long as 40 years. Increasingly these programs have wiped out the previously existing distinctions between manufactured home finance and traditional site-built home finance. In this and other areas, manufactured housing is moving closer to parity with other forms of housing.

Similarly, the old distinctions with respect to the nature of ownership interests and zoning constraints are also breaking down. In many states, when a manufactured home is attached to real estate through some form of permanent foundation, and the

home and lot together are owned by the same party, the home is eligible for treatment as real property for taxation, titling and other legal purposes. In virtually all states in the West, this now has been made clear as a matter of specific state law. In Fleetwood's home state of California, all manufactured homes are taxed as real estate whether on fee owned or leased land. As a result of these developments, there is a strong movement, particularly in the West, toward the development of manufactured housing subdivisions or tracts. Also, slowly but surely, the use of manufactured housing for city-lot infill purposes is expanding.

In addition, the old zoning barriers which effectively have kept manufactured homes off residential lots have begun to break down. Legislatures and court cases in Michigan, New Jersey, New Mexico and Vermont have struck down restrictive zoning practices which discriminated against manufactured home owners. Last year, the California legislature enacted far-reaching legislation to require local communities either to permit manufactured homes attached to permanent foundations on any zoned residential lots or to make reasonable alternative treatment available to manufactured housing. S.B.1960 became effective only last July and the current economic downturn has inhibited its use on any substantial basis. Once high interest rates abate, however, we believe we will see substantial use of manufactured homes in a residential context in California. Almost without exception, the local zoning ordi-

nances adopted by county and municipal governments in accordance with S.B.1960 were favorable and in keeping with the spirit, as well as the letter, of the legislation.

Mr. Chairman, as Title V of S.1702 proves you well understand, the image and role of manufactured housing in today's housing market is rapidly changing. It is in view of this changing role that we offer the following comments today.

II. S.1702

Experimental Insurance Authority

The Coordinating Council applauds the Chairman's recognition of FHA's role as an innovator and leader in the development of new forms of home finance. It is indeed unfortunate, as the Chairman noted in his introductory remarks to S.1702, that FHA has relinquished that role with respect to adjustable rate finance mechanisms. As you know, Mr. Chairman, as a result of today's competitive capital marketplace and the present revolution of our financial system, particularly with regard to home lending, available funds for housing finance are in short supply. Manufactured housing must compete with traditional site-built housing for a limited pool of funds. We are manufacturers and retailers, not lenders. We would therefore prefer to have long-term fixed rate financing made available to help us sell more homes. Unfortunately, we are acutely aware of the nation's economic climate. Recognizing the current need

for adjustable rate finance, however, we believe that there is still a need for long-term fixed rate financing, and we believe that such financing should continue to be offered by FHA.

The manufactured housing industry has a unique interest in the development of finance programs that afford maximum creditor flexibility because of the industry's traditional involvement with personal property finance, and more recent involvement with real property finance and the combination of the two (depending upon the type of transaction and the characterization of manufactured homes under state law). No single finance option will necessarily be the best for all categories of products in all circumstances. We, therefore, believe that adjustable rate loan and credit sale instruments will be a key form of innovative finance for meeting the needs of consumers and the manufactured housing industry.

We believe that a ready source of funds for manufactured housing finance is necessary to meet the nation's need for affordable housing. For many families, particularly first-time home buyers and the elderly, manufactured housing is the only form of affordable housing. Because manufactured housing must compete with traditional site-built housing for limited funds, comparable finance instruments and credit terms must be made available to manufactured housing or it will be at a competitive disadvantage with typically higher priced site-built housing.

Unfortunately Section 101 of S.1702 applies only to homes insured under Title II of the National Housing Act. While the

provisions of this bill would authorize Title II financing for certain manufactured homes, most would still be financed under the Title I program. We therefore urge the Subcommittee to extend this experimental insurance authority to loans and credit sales insured under Title I of the National Housing Act as well as to those insured under Title II.

Mr. Chairman, we have one further suggestion for amending Section 101 which we would like to note for the record. Subsection (c) states that no "mortgagor or borrower who . . . has owned a dwelling unit within the 3 years preceding the date of the application for insurance" is eligible for participation under this experimental program. While we recognize and fully support the Chairman's intent to broaden FHA finance programs for first-time homebuyers, we are concerned that this limitation may have a negative impact on the equally important goal of providing affordable housing for a wide sector of the population unable to obtain credit elsewhere. Frequently, for example, the elderly, whose real return on pensions and savings plans has deteriorated with inflation, are forced to sell their homes (particularly when childern have grown and moved away) and to purchase smaller, more affordable and practical homes. Because the elderly frequently live on limited incomes, they may be denied credit in today's volatile market. Another group that may be hurt by this provision are young couples who have purchased a small first home and may choose, perhaps due to a growing family, to move up either to a larger manufactured home

or site-built home. This group too may have difficulty in obtaining credit in today's market and so has an equal need for an innovative program such as that proposed in Section 101.

We therefore propose that Subsection (c) be deleted and that FHA be instructed to promulgate regulations regarding the proper targeting and shaping of this program.

Although we applaud Section 101's innovative proposal for adjustable rate finance FHA programs, we are concerned that the entire program may be of little benefit because the laws of a large number of states work to prohibit or severely restrict the use of any form of adjustable rate finance. Last month, testimony was offered before the full Senate Banking Committee by both the Mortgage Bankers Association and the Task Force on Creative Finance for Manufactured Housing, proposing a federal preemption of all state laws that prohibit, restrict or impede the use of adjustable rate finance instruments. Federally chartered depository institutions currently benefit from such a preemption. However, a large percentage of FHA loans are made by mortgage bankers, finance companies, and state-chartered institutions. A federal preemption of restrictive state laws would permit all types of lenders to compete on an equal basis in the financial markets. This competition would ultimately benefit homebuyers. We believe that without such a preemption, new Section 247 will be of use only in a limited portion of the country and will not have the positive impact on credit availability that is intended.

Five Year Mortgages

The Coordinating Council strongly supports the implementation of a provision that would authorize short term renegotiable rate or "rollover" mortgages. We further endorse the authorization of GNMA to purchase such mortgages and the intent, as expressed in the Chairman's introductory floor statement, to provide for short-term mortgage-backed securities. It is no secret that in today's bond markets there is little interest in long-term fixed rate securities (including mortgage-backed securities). Therefore, the ability to enter the secondary market with a short-term debt security would be of great value to both the site-built and the manufactured housing industries.

Unfortunately, only those manufactured homes insured under Section 203(b) of the National Housing Act would be eligible to participate in these renegotiable rate mortgage and short-term mortgage-backed securities programs. The same market conditions that make implementation of such a provision necessary for site-built home loans necessitate similar action for Title I insured manufactured home loans. As previously stated, to exclude Title I insured manufactured home loans from the creative finance provisions would be to place those loans, and the securities they back, at a competitive disadvantage in the secondary market. We therefore urge the Subcommittee to include similar insurance authority for Title I insured manufactured home loans.

Condominiums

The Coordinating Council generally supports the condominium provisions of Title III of this bill. We believe that for many families the condominium is the most affordable and practical type of housing. We do, however, have one comment to make. We recommend that the Subcommittee provide for Section 234 condominium loan insurance for manufactured homes constructed to the HUD Code. You will recall, Mr. Chairman, in an amendment that you sponsored to the Omnibus Budget Reconciliation Act of 1981 (P.L. 97-35), manufactured homes were included as eligible housing under Section 234 of the National Housing Act. Manufactured homes, however, in order to qualify for Section 234 financing, must be constructed to the HUD minimum property standards and not the HUD Code. In view of the provisions of Title V of this bill which authorize Section 203(b) financing for manufactured homes constructed to the HUD Code, we believe that a provision should be added to this bill that would expressly authorize the financing of HUD Code manufactured home condominium units under Section 234. This change would also conform to the recent decision of the Federal National Mortgage Association to purchase condominium and other single-family manufactured home loans where the home is constructed to HUD Code standards. We believe that the inclusion of HUD Code constructed manufactured homes would be consistent both with the provisions of this bill and with the reality of the marketplace as illustrated by FNMA's recent decision. Moreover, such a

provision would help stimulate further introduction of manufactured homes in condominium settings -- a truly significant affordable housing innovation. We also suggest that a similar amendment be made to the Section 213 cooperative housing program.

Mortgage Insurance for Homes on Leased Land

Mr. Chairman, we support the intent of this provision because it recognizes that in some areas of the country people are choosing to build homes on leased land. However, we are uncertain as to what Section 401 is intended specifically to accomplish. FHA regulation 24 C.F.R. §203.37 currently states that a mortgage is eligible for insurance if "on leasehold under a lease for not less than 99 years which is renewable or under a lease with a period of not less than 50 years to run from the date the mortgage is executed." Section 401 of this bill contains no reference to a specific term of the lease necessary to qualify for insurance, but adds a requirement not present in the current statute that the mortgagor have an option to purchase the land. We believe that this provision should be clarified in order, as we believe was intended, to expand the opportunities to utilize FHA financing where a suitable leasehold interest is involved. The use of land leases could be an important tool in providing affordable housing. We propose that express authorization be added for financing of leasehold improvements.

We further propose that similar express authority be added to Section 2 of the National Housing Act, particularly with respect to combination manufactured home and lot loans where the lot is held under a long term lease. We believe that a combination manufactured home and lot financed under Title I should have the same opportunity to take advantage of the recent developments in leasehold financing as a site-built home and land insured under Title II of the National Housing Act.

Mortgage Insurance on Certain Homes

Mr. Chairman, I believe that on this point I can speak on behalf of the entire manufactured housing industry in praising this clear statutory resolution of an ambiguity which has plagued both HUD and the manufactured housing industry for quite some time. The provisions of Section 501 of this bill would authorize Section 203(b) insurance of combination manufactured home and land loans on a site-built permanent foundation on a parity basis with other single-family homes. We assume that "site-built" means "site erected" or site assembled" in view of recent technological advancements in the area of factory-produced foundation systems.

As we believe you are well aware, the manufactured housing industry has held numerous meetings with officials of FHA to determine the circumstances under which a manufactured home and lot, when classified as real property under applicable state law, could be financed under Section 203(b). The response of

the FHA to this changing environment is generally commendable as well, although it is only a temporary step at this time. As you may know, Mr. Chairman, in late 1980 the FHA agreed that new manufactured homes could be considered "existing homes" for purposes of Section 203(b) financing under certain circumstances. This decision was originally made on a temporary basis, but it has been extended several times and is currently operative permitting the financing of many manufactured homes and lots under the FHA's traditional home loan program.

Since then, the new administration has been working with segments of the industry to develop final requirements so that certain manufactured homes can be placed in the Section 203(b) program on a more permanent basis. We commend the Department, and particularly FHA Commissioner Winn and his Deputies Bowers and Abrams, and the members of their staffs who have participated in this effort.

As yet, no such final requirements have been established, perhaps due to concern over the limits to the Department's authority in this regard under its governing statutes. We believe this proposed legislation will be extremely useful in establishing without question the Department's authority to include manufactured home loans in the Section 203(b) program on a broad basis.

As I have mentioned previously, the Federal National Mortgage Association recently decided to purchase HUD Code manufactured homes affixed to real property under all of its

single-family home programs on a parity basis with site-built homes. This important decision has been considered within the manufactured housing industry to be a tremendous stride toward providing new secondary markets for manufactured home loans. This provision of S.1702 will authorize FHA to follow the lead of FNMA and the private sector.

Mr. Chairman, notwithstanding the importance of this provision, we do not want to lose sight of the fact that the Title II finance programs can never replace the need for a continued strong Title I insurance program. The importance of the Title I program cannot be overemphasised. Title I is a coinsurance program where the lenders share the risk of loss with FHA. In return for risk sharing, the lenders are permitted to do their own loan underwriting and processing without Federal regulatory involvement. For this reason, and because the FHA Title I staff has an impressive working knowledge of the intricacies of manufactured home finance, the Title I program operates efficiently with minimal red tape. This has led to substantial cost savings for both lenders and the government.

As we understand it, the Title II programs require that mortgages be secured by real property. However, a combination manufactured home and lot are not classified as real property in all states. Therefore, the Title I combination land and home program will continue to be necessary for financing a mixed realty and personalty combination in many states. Even where combinations are classified as real property, a lender

may still wish to elect the shared risk Title I coinsurance program because of the savings in paperwork and red tape. In addition, manufactured homes as traditionally financed -- without land -- will not be able to qualify for Title II financing.

III. Issues Not Addressed in S.1702

Mr. Chairman, the Coordinating Council would like to take advantage of the opportunity presented by these hearings to comment on several items which are not contained in S.1702 but which we believe require legislative attention.

HUD Implementation of Legislative Authority

First, Mr. Chairman, the Associations on whose behalf I am speaking today would like to express their appreciation to the entire Congress, and particularly this Committee and to you, for recognizing the importance of manufactured housing as a means of providing affordable housing. Mr. Chairman, you and this Committee have sponsored and supported numerous provisions over the past several years which steadily have improved financing for manufactured homes.

Unfortunately, Mr. Chairman, much of this legislative work has not been implemented by HUD and therefore the full benefits to both home buyers and the manufactured housing industry have not been realized. As you well know, the Housing and Community Development Act of 1980 contained a number of important manufactured home finance amendments, including loan limit

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increases for manufactured home and for combination manufactured home and land loans as well as provisions for high cost area adjustments. The loan limits for manufactured homes were not implemented until this past September 28th, almost a full year after the enactment of the legislation. The increased loan limits for combination manufactured home and land loans and high cost area adjustment provisions have not yet been implemented. This past summer, the Omnibus Budget Reconciliation Act of 1981 was enacted. This legislation contained further loan limit increases for both manufactured homes and combination manufactured home and land loans. The legislation also contained an increase in the loan term for certain manufactured home loans and included new Section 8 rental assistance payment authority for manufactured homes. This new authority also has not been implemented.

We understand how busy HUD is, and that staff shortages may have contributed to the delay. These delays, however, are frustrating, and we hope that in the future procedures will be improved to expedite regulatory implementation of important legislation.

Employee Retirement Income Security Act Amendments

I would like to comment briefly on S.1678, a bill which you, Mr. Chairman, cosponsored with Senator Hatch to amend the Employee Retirement Income Security Act (ERISA) so that private pension funds can invest more freely in residential lending.

As you have already noted in your Congressional Record statement accompanying the introduction of S.1702, the secondary market will have to expand significantly tc meet the future housing finance needs of our nation. Private pension funds constitute the single largest source of additional funds for use in the secondary market. While S.1678 has not been referred to the Banking Committee, in view of your role in this proposed legislation and the very substantial impact it may have on the housing market, I thought our analysis of this bill from the standpoint of manufactured housing might be of interest.

Under present law, private pension fund investment in the conventional housing market has been very limited, although there has been significant pension involvement with the GNMA mortgage-backed securities program. More recently, pension investment of this kind was facilitated by a Department of Labor grant of a "class exemption" from the prohibited transactions provisions of ERISA. This exemption allows for the purchase of interests in certain mortgage pools by ERISA pension funds (Dept. of Labor, Prohibited Transaction Exemption 81-6, January 23, 1981). As defined by Section III B. of the exemption, the term mortgage pool means "an investment pool the corpus of which . . . is held in trust; and " . . . consists solely of . . . [i]nterest bearing obligations secured by first mortgages or deeds of trust on single-family residential property . . ." (emphasis added). S.1678 would expand that investment ability by authorizing direct pension fund investing in "residential

housing mortgages" (we assume including real property manufactured home and land mortgages) subject to certain specified conditions (emphasis added). Thus, direct purchases of whole loans or participations in such loans would be permitted.

As we pointed out earlier in this statement, manufactured housing is not principally financed through a mortgage or deed of trust instrument, other than when a manufactured home and lot are financed together as real property. More frequently, loans for manufactured homes in combination with, and affixed to, real property, are executed as personal property loans or credit sales, because the security is chattel rather than real estate. Both the present Labor Department class exemption for "mortgage" pool investment and the authority proposed in S.1678 for direct investment in "mortgages" would thus preclude private pension fund involvement in the majority of manufactured home loans. We believe that this was an unintended exclusion, and wish to call it to your attention so that the appropriate remedial action may be taken.

Negotiated Interest Rates

The Housing and Community Development Act of 1980 authorized limited demonstration authority for negotiated interest rates for the Section 203(b) mortgage insurance program. This authority was extended by the Omnibus Budget Reconciliation Act of 1981. We strongly support the concept of negotiated interest rates. It is our position that competition in the marketplace

will serve to regulate interest rates more effectively than will the imposition of artificial rate ceilings by FHA. Presently, when FHA loan limit ceilings are too low, lenders either abandon the FHA market for the conventional market or compensate by increasing seller points. On the other hand, when the FHA interest rate has remained high in a falling interest rate market, lenders in the FHA program originate loans at competitive market rates, regardless of their ability to charge a higher FHA rate. We believe that this proves that artificially established FHA interest rate ceilings serve little purpose, and we strongly endorse the concept of negotiated interest rates.

We would like to urge the Subcommittee to consider extending the negotiated interest rate authority to the Title I manufactured home loan insurance program. The same marketplace competitive forces that enable such a program to work with Section 203(b) mortgages act upon the Title I loan market. The introduction of the negotiated interest rate for all FHA insurance programs would be a major step toward deregulation and would appear to be consistent with the goals of the Administration and the Congress.

Existing Manufactured Home Title I Loan Insurance Program

Current FHA Title I regulations prohibit the insuring of loans for existing manufactured homes unless the homes were previously financed under Title I (24 C.F.R. §201.510). We

believe that this regulatory restriction is not required by the National Housing Act. An amendment to the National Housing Act specifically authorizing Title I insurance on loans for the purchase of existing manufactured homes, regardless of how they were financed previously, would be consistent with the spirit of this bill.

Today there is a large stock of quality built existing manufactured homes. The lack of adequate financing harshly deprives the homeowner of the ability to sell his home at a fair price. We believe that this existing stock of affordable housing should be used and that steps should be taken to make available new means of financing. We propose that the Subcommittee consider adding a provision to S.1702 that would expressly authorize FHA to accept existing manufactured homes for insurance under Title I of the National Housing Act, regardless of previous financing.

IV. Conclusion

In conclusion, I want to thank you, Mr. Chairman, and the entire Subcommittee for allowing me the opportunity to appear before you today on behalf of my company, the Western Manufactured Housing Institute, and the Coordinating Council on Manufactured Housing Finance to testify on this important and innovative bill. We strongly endorse the thrust of this bill and the course which it charts for expanded FHA authority to restore its role as an innovator in providing financing for

affordable housing for those sectors of our population that truly need government-insured credit. We hope that you will give serious consideration to acting upon our suggestions.

Again, thank you, Mr. Chairman. I would be pleased to answer any questions you might have, and our Washington counsel would be happy to work with the Subcommittee staff in perfecting any of the recommendations we have made today.

Senator LUGAR. Thank you very much for coming, Mr. Weide. The Chair now calls upon Mr. Shea.

STATEMENT OF JIM SHEA, FAIRMONT HOMES, NAPPANEE, IND.

Mr. SHEA. Mr. Chairman, I wish to express my appreciation for having this opportunity to appear before this committee. I am chairman of the board of Fairmont Homes and have been associated with the mobile home industry in some capacity—first, as an attorney in the 1960's and then later manufacturing myself—for some 20 years. I am here today to testify in support of S. 1702 and I wish to thank the chairman again and the committee for this opportunity, and also express my gratitude for the fine cooperation that I've gotten from this committee staff, and I think the staff of MHI, whom I'm also appearing for, would likewise extend that appreciation.

I should also point out that I am a member of the Manufactured Housing Institute, the national trade association of manufacturers and suppliers in the production of mobile/manufactured housing. I have with me Mr. Andrew Murphy, MHI counsel. There are perhaps 178 mobile home manufacturers in the United States with close to 500 facilities. These manufacturers in the year 1980 distributed almost a quarter of a million homes to the continental United States and Alaska. MHI represents more than 70 percent of this production capability for manufactured housing. And I might add that, according to the Commerce Department, the 221,000 homes sold by this industry last year represent approximately 30 percent of the new single family homes actually sold in the United States. What's more important, this represents perhaps 75 percent of the homes sold under $50,000. The average price of a manufactured home sold in the United States in the year 1980 was $19,000.

Insofar as a significant number of our homes are financed under the FHA program, particularly title I, we are vitally interested in S. 1702 and very supportive of the needed changes which it would make, and we would commend you, Senator Lugar, for your judgment and initiative in introducing this legislation.

MOBILE HOME FINANCING

We speak especially in support of title V, which would authorize HUD to include mobile home financing under the section 203(b) mortgage insurance program; that is, the title II program; and would put mobile homes and manufactured housing on a parity with site-built homes. This legislation is particularly important and

represents a major step in the fulfillment of a long sought goal, and I believe a deserved right, an earned right of the manufactured housing industry. For several years now we have been working with HUD officials to pursuade them of the need to include manufactured housing in the title II program.

Now we have HUD standards and we live up to those standards. I believe the record reflects that fact. Those standards, we believe, are the equivalent of your minimum property standards and we believe that with a HUD-approved home that we should qualify under the title II program without reference to MPS.

The changes which S. 1702 would produce are needed now perhaps more than at any other time. Current changes in the marketplace present several very important reasons why S. 1702 should be enacted. For one thing, past fears about the quality of construction and durability of our product are no longer justified in any way. Several recent studies and comparisons of the HUD manufactured housing code with other traditional building codes indicate that in almost every instance the HUD code is equal to, or exceeds, these other codes. Therefore, there is no rational or supportable reason why manufactured homes built to the HUD code should not be included in FHA's traditional 30-year mortgage insurance program. Our products are of high quality and at least as safe and as durable as other forms of single family housing.

A second major reason supporting the need for title V of S. 1702 is the emerging trend toward larger numbers of our homes being placed on private property, permanently attached to the land, and financed as real estate in conventional mortgage transactions. Several recent factors occurring in the marketplace indicate that this trend will continue and will increase the demand for the new program changes envisioned by title V. For example, the industry has been making very great progress in eliminating the historical zoning barriers, and land use restrictions, which have operated against the placement of our product within the boundaries of communities and in existing residential subdivisions. Favorable recent actions in State legislatures such as in Indiana and California have ended unreasonable and unnecessary exclusionary zoning practices; and corresponding decisions in the supreme courts of States such as Michigan and New Hampshire have ended unreasonable land use restrictions there. Indeed, the Congress and this committee, in particular, have expanded the range of loan insurance and subsidy programs available to manufactured housing. The result is that in the future more and more of our homes will be placed on private property, taxed and financed as real estate, and conveyed with the land when sold; and, therefore, should be eligible for financing under the new FHA authority which title V would establish.

Lenders themselves are beginning to recognize this trend and have been making adjustments in the private sector on their own. The Federal National Mortgage Association, for example, has recently announced the establishment of a major secondary market for loans for mobile homes permanently attached to land and treated as real estate. The changes authorized by title V are consistent, also, with this new trend in the lending community.

In addition to the fact that the quality of construction of manufactured housing merits title II financing, and in consideration of the fact that the current trends in the marketplace make it necessary, there is a third factor operating in support of the need for title V. That is, the issue of affordability. As manufactured home producers, we are doing everything possible to enhance affordability by eliminating every unnecessary cost from the structure and also doing everything possible to improve our production efficiency, and we meet a need that is almost a social political need in this country.

MARGINAL HOME BUYER

We talk about the marginal buyer. The marginal buyer today is virtually any young person and oftentimes every older person who is seeking a retirement home and is living on a pension or some other fixed income. So we are really talking about vast numbers of home buyers, most home buyers, the biggest share of home buyers. In order to serve their needs, which are really social political in character and will prove more and more that way, manufactured housing has to be able to do their share of satisfying this growing need and we can do that with S. 1702.

Inasmuch as FHA title II loans generally carry an interest rate somewhat less than the conventional mortgage market rates, and those which prevail in the existing title I mobile home program, the implementation of title V would enhance affordability by granting a certain class of mobile home loans more favorable terms and conditions than they would have under title I.

For the same reasons, the manufactured housing industry also supports those provisions in S. 1702 which would grant FHA the authority to experiment with innovative financing techniques. We believe these changes are necessary and we believe that they are necessary because of the capital shortages that are apparent and the crowding out of home lenders in the credit markets. We think the time to enact them is now so that they are in place so that if we carry forward in this country in an attempt to correct the economic conditions that prevail we can have an in-place piece of legislation that allows FHA the flexibility that it will need to meet changing conditions. We don't believe that you can put this in the cupboard and think about it and wait for a crisis to develop. We are in a crisis and we believe that these innovative features should be put in place now and should be there to serve the needs of this country.

[Complete statement follows:]

STATEMENT OF JAMES F. SHEA, CHAIRMAN OF THE BOARD, FAIRMONT HOMES, NAPPANEE, IND.

Mr. Chairman: My name is Jim Shea and I am Chairman of the Board of Fairmont Homes, a major producer of manufactured housing, based in Nappanee, Indiana. I am here today to testify in support of S. 1702 and I wish to thank the Chairman and the Committee for this opportunity.

I should also point out that I am a member of the Manufactured Housing Institute and I am here today to testify on behalf of that organization. MHI is the national trade association representing the manufacturers and suppliers engaged in the production of mobile/manufactured housing. There are an estimated 178 mobile homes manufacturers in the United States with approximately 470 facilities. In

1980 these manufacturers distributed over 221,000 homes to the continental United States and Alaska. MHI represents more than 70 percent of this production capability for manufactured housing. And I might add that, according to the Commerce Department, the 221,000 homes sold by this industry last year represent approximately 30 percent of new single family homes actually sold in the United States.

As you might suspect, we are very proud of our role in producing this large number of affordable homes for American families. While less than 25 percent of site-built homes sold in 1980 were priced under $50,000, virtually all of the manufactured homes sold during that same period sold for less than that. The Commerce Department figures indicate that in 1980 the average cost of mobile homes was $19,200 compared to the average price of a site-built home of $76,300.

Insofar as a significant number of our homes are financed under the FHA program, we are vitally interested in S. 1702 and very supportive of the needed changes which it would make; and I would like to commend Senator Lugar for his judgement and initiative in introducing this legislation.

I speak especially in support of Title V, which would authorize HUD to include mobile home financing under the Section 203(b) mortgage insurance program, i.e., the Title II Program. This legislation is particularly important and represents a major step in the fulfillment of a long sought goal of the manufactured housing industry. For several years now we have been working with HUD officials to pursuade them of the need to include manufactured housing in the Title II Program.

The changes which S. 1702 would produce are needed now, perhaps more than at any other time. Current changes in the marketplace present several very important reasons why S. 1702 should be enacted. For one thing, past fears about the quality of construction and durability of our product are no longer justified in any way. Several recent studies and comparisons of the HUD manufactured housing code with other traditional building codes indicate that in almost every instance the HUD code is equal to, or exceeds, these other codes. Therefore, there is no rational or supportable reason why manufactured homes built to the HUD code should not be included in FHA's traditional 30-year mortgage insurance program. Our products are of high quality and at least as safe and as durable as other forms of single-family housing.

A second major reason supporting the need for Title V of S. 1702 is the emerging trend toward larger numbers of our homes being placed on private property, permanently attached to the land and financed as real estate in conventional mortgage transactions. Several recent factors occuring in the market place indicate that this trend will continue and will increase the demand for the new program changes envisioned by Title V. For example, the industry has been making very great progress in eliminating the historical zoning barriers, and land use restrictions, which have operated against the placement of our product within the boundaries of communities and in existing residential subdivisions. Favorable recent actions in state legislatures such as in Indiana and California, have ended unreasonable and unnecessary exclusionary zoning practices; and corresponding decisions in the Supreme Courts of states such as Michigan and New Hampshire have ended unreasonable land use restrictions. Indeed, the Congress and this Committee, in particular, have expanded the range of loan insurance and subsidy programs available to manufactured housing. The result is that in the future more and more of our homes will be placed on private property, taxed and financed as real estate, conveyed with the land when sold; and, therefore should be eligible for financing under the new FHA authority which Title V would establish.

Lenders themselves are beginning to recognize this trend and have been making adjustments in the private sector on their own. The Federal National Mortgage Association, for example, has recently announced the establishment of a major secondary market for loans for mobile homes permanently attached to land and treated as real estate. The changes authorized by Title V are consistent, also, with this new trend in the lending community.

In addition to the fact that the quality of construction of manufactured housing merits Title II financing, and in consideration of the fact that the current trends in the market place make it necessary, there is a third factor operating in support of the need for Title V: that is. the issue of affordability. As manufactured home producers, we are doing everything possible to enhance affordability by eliminating every unnecessary cost from the structure and also doing everything possible to improve our production efficiency.

However, in this age of high interest rates, tight money, and inflation, it has become necessary to look also at financing procedures, loan instruments and so forth, to improve the factor of affordability for consumers; and I believe that is what S. 1702 is all about. In as much as FHA Title II loans generally carry an interest

rate somewhat less than the conventional mortgage market rates, and those which prevail in the existing Title I mobile home program, the implementation of Title V would enhance affordability by granting a certain class of mobile home loans more favorable terms and conditions.

For the same reasons, the manufactured housing industry also supports those provisions in S. 1702 which would grant FHA the authority to experiment with innovative financing techniques. These changes are necessary if FHA is to continue to be of assistance to the increasing number of marginally qualified buyers who are in many cases young families and first time home buyers. In today's financing market, alternative mortgage instruments and innovative financing techniques are absolutely essential if there is to be a constant supply of funds for housing; and to maintain FHA's ability to sell mortgages in the secondary market.

Therefore, MHI strongly supports all of the provisions for new loan insurance authority which will be granted to FHA under the provisions of S. 1702.

Mr. Chairman, there are, however, two areas of importance to the manufactured housing industry which are not specifically addressed by S. 1702 and which I believe deserve attention.

The first of these concerns is the FHA Title I loan insurance program under which FHA insures personal property and retail installment loans for mobile homes. As you know, this is the traditional FHA manufactured home program which has served the industry well over the years. It is unique and very useful to our industry because our homes are often placed on rental property in mobile home park setting. We have every reason to believe that a great number of people will continue to be housed in this fashion for a long time to come; and they are subject to the same economic problems, such as inflation and high interest rates, which are faced by all other home buyers.

Unfortunately, current law and regulations do not permit FHA to insure Title I loans which make available these new innovative financing techniques. As a result, we expect Title I financing to become less available, unless changes are made along the lines described in S. 1702 for the FHA 203(b) program. Many lenders have expressed to me, and my colleagues in the industry, a growing reluctance to make Title I loans unless new forms of alternative financing are make available. For example, FNMA has indicated that it will not fully implement a secondary market for Title I loans unless these new innovative financing techniques are adopted. Therefore, I hope the Committee will give consideration to an amendment which would grant FHA the authority to experiment with, and develop, alternative financing techniques under the Title I program, the same as you are doing with Title II.

The second item of concern pertains to the wording of that part of Section 501 which requires that manufactured housing "be secured by a dwelling which is affixed to a site-built permanent foundation", in order to be eligible for 203(b) financing. The phrase "site-built permanent foundation" could use some clarification. For example, I am aware of certain manufactured home mechanical foundation systems which are permanent but not site-built. I doubt that it is the intent of S. 1702 to exclude such systems and technology by the inclusion of these words.

I also doubt it is the intent of the Committee to rule on the relative merits of various foundations systems, but rather, to ensure that the home is permanently affixed to the land and, therefore, meets the definition of real property. Therefore I would suggest the current wording be amended to read "secured by a dwelling permanently affixed to real property." This language is similar to that which has been adopted by FNMA in its new manufactured housing program.

In concluding, let me reiterate that the manufactured housing industry wholeheartedly supports the provisions of S. 1702; and on their behalf I would like to express appreciation to Senator Lugar for introducing this timely piece of legislation. For myself, I would like to thank the Chairman and members of the subcommittee for granting me the opportunity to testify here today.

Mr. Chairman, this concludes my remarks and I will be happy to respond to any questions the Committee may have.

Senator LUGAR. Thank you very much, Mr. Shea.

In testimony that you gentlemen have presented you addressed a basic question which the subcommittee would have about the percentage of new homes construction and manufactured housing and you've also addressed the number of buyers who are lower income and first-time buyers and the cost savings that are available.

Let me ask this question. It's been touched upon but maybe you could offer further testimony.

Will 203(b) financing offer significant improvement over the current title I program, and in what ways will the financing be less expensive for the consumer?

Mr. WEIDE. Well, the first thing, Senator, just shortly it would reduce the downpayments and it would extend the time terms in which the payments would be made and that in itself would have to be an improvement.

Senator LUGAR. Let me touch on one point that has been mentioned in the testimony. Perhaps you can offer further information for the record.

COMPARING HOUSING CODES

Is the manufactured housing code as safe as the minimum property standards? Do the codes differ in any way that would jeopardize the security of the Federal insurance if we were to use the manufactured housing code rather than MPS?

Mr. BLOMGREN. Mr. Chairman, I think this is a legitimate concern on the part of HUD, that the FHA insured loan should not be put in jeopardy as a result of the program to accommodate manufactured housing, but I think there's general agreement among those who have analyzed comparatively the standards—the MPS standards, for example, versus the HUD code standards—that the differences that exist there are traceable primarily to the fact that the HUD code is a performance standard, not a specification standard.

Second, that the HUD standard has within it requirements which address the delivery system of the home from its manufactured site to its installation on the ground, whereas the MPS is designed for a completely different purpose which addresses those problems and concerns which relate to building the structure or assemble it on its site.

But comparing these codes in terms of the real issues of structural integrity and safety, longevity, the ability to withstand thermal tests of high temperatures, wind loads, snow loads and the like, I think that there are no substantial differences and I think there must be general agreement on that, probably reinforced by some opinions expressed by the Institute of Building Sciences.

Senator LUGAR. Well, I simply want to express on behalf of the subcommittee and the full committee our appreciation to this panel for coming this morning. Your statements are comprehensive and your summaries have focused on issues that are very important. We are hopeful of gaining additional interest in S. 1702 and your presence and the presence of the other witnesses has been a material factor in enhancing that interest.

At this time, the Chair will recess the hearing with thanks to all witnesses and all who attended.

[Whereupon, at 12:45 p.m., the hearing was adjourned.]

[Additional material received for the record follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS

To: Senate Banking Committee.
On: FHA Revitalization Act of 1981.
By: Roy Fair.

Mr. Chairman, I am Roy Fair, a realtor from Aurora, Illinois and 1982 Chairman of the National Association of Realtors® Legislative Committee.

Thank you for providing the National Association of Realtors with the opportunity to discuss the role of the Federal Housing Administration's unsubsidized mortgage insurance programs and your legislation, S. 1702, the "FHA Revitalization Act of 1981." Mr. Chairman, in the remarks you delivered upon introduction of your legislation, you noted "the time has come for a new spirit at FHA." We wholeheartedly agree that now is an excellent time to reflect on the FHA unsubsidized insurance programs and S. 1702 is an excellent catalyst for this review.

The Federal Housing Administration and the mutual mortgage insurance system were established by the National Housing Act of 1934. The 1934 Act was one of many things which the Federal Government initiated during the early and middle 1930's to generate new economic activity. In the field of housing, it proposed to contribute to this end entirely by facilitating and stimulating the investment of private capital. The problem became how to trap this source of capital, how to reassure private lenders that they would be protected from a repeat of the Depression debacle.

During the years of the Depression, mortgage lenders had lost so much money that subsequent investment in residential mortgages was considered to be a form of economic suicide. Lenders had seen their mortgage portfolios converted overnight through defaulted loans into vast holdings of unwanted properties which were essentially unsaleable because no one could afford to buy them. Lenders in significant numbers went bankrupt, losing the properties as well as the loans.

The concept of FHA mortgage insurance was developed to induce lenders to invest in residential mortgages by insuring them against loss on such investments. In exchange for the protections, FHA was authorized to set certain standards for participants in the program.

One of the first devices designed by the FHA to add stability to the mortgage market was the long-term, fixed-rate, amortized mortgage instrument. It replaced an instrument characterized by a high-rate, short-term and balloon-type payment with downpayments often being as high as 50 percent. FHA programs induced lenders to view an adequately secured first mortgage loan as a sounder and, in the long run, more profitable instrument than a multi-tiered debt structure which could collapse at the slightest disturbance in the circumstances of the borrower.

For some forty years, the FHA has satisfied the needs of borrowers and lenders and precluded the need for an alternative instrument. However, many of the realities of the marketplace that determined FHA parameters and procedures have drastically changed, principally due to the monetary policy undertaken by the Federal Reserve Board since October of 1979 and the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980 which began phasing out Regulation Q and deregulating depository institutions. Long- and short-term money rates have inverted making lending-long and borrowing-short a money losing proposition. The relationship between mortgage rates and inflation have changed as well with the traditional "spread" for a real (after inflation) rate of return increasing beyond traditional levels. The last few years have also seen extremely volatile and expensive costs of capital further damage the flow of adequate money into mortgage financing.

Within the last six months, the Federal Home Loan Bank Board has addressed this dilemma by issuing sweeping regulations authorizing federally chartered institutions to develop an adjustable mortgage loan instrument that could have whatever characteristics deemed necessary to market the loan. The Comptroller of the Currency has also issued somewhat more restrictive regulations for ARM's. Although the intentions were sound, the concept of the adjustable rate mortgage has been hard to sell.

General market conditions have been so soft that mortgage lending activity by financial institutions is at a virtual standstill.

Mr. Chairman, as you are well aware, interest rates have been so high that the vast majority of American homebuyers have been unable to afford new mortgages of any kind, either fixed or adjustable rate. Not only are the fully amortized fixed-rate mortgages unaffordable for most Americans, they are increasingly harder to find as more and more lending institutions refuse to offer them at any price. A recent survey, several months ago, of 400 S&L's commissioned by the American Mortgage Insurance Company of Raleigh, N.C. showed that only 41 percent of the institutions

questioned did offer fixed-rate mortgage loans. In some areas of the country, California most notably, the percentage of lending institutions offering fixed-rate financing is much less.

As the federally sanctioned mortgage instruments have become inoperable in today's economic environment, there has been an exponential increase in the number of homesales provided through a variety of financing plans known collectively as creative financing.

The National Association of Realtors estimates for 1980 and all of 1981 that more than 60 percent of the 5.6 million resale transactions which take place will involve the use of creative financing techniques. The most frequently used technique is direct assumption of the existing mortgage loan by the homebuyer, utilized in an estimated 42 percent of all resale transactions in 1981. The second most frequently used technique is assumption with a second mortgage, involved in 34 percent of all resale transactions during the same period. Another major component of creative financing is when the seller of the home provides financing, usually at below the current market levels. The prevalence of creative financing is an indication that "official" methods of financing homesales simply are not working."

I would now like to address some of the specific provisions of S. 1702.

Title I of S. 1702 provides the Secretary of HUD with general experimental insurance authority to develop innovative mortgage insurance programs for first-time homebuyers. Obviously, there is a real need to see that the millions of house-seekers in the so-called "Baby Boom" generation can purchase a home.

These potential first-time homebuyers are unable to accumulate enough savings out of their earnings to make the initial downpayment. This inequity is one reason why the percent of first-time homebuyers dropped from 36 to 18 percent of all buyers between 1977-1979. If the affordability threshold for these first-time homebuyers is exacerbated, serious long-term social problems will arise. Whatever FHA can do to develop new mortgage instruments that can satisfy the needs of lenders yet fit within the budget of these people should be encouraged and even mandated by the Congress. The Association fully supports all efforts to assist the first-time homebuyer.

However, the focus of Title I on the first-time homebuyer may restrict millions of other Americans from access to needed housing. The subcommittee should keep in mind that many homebuying Americans cannot afford to buy the houses in which they currently live. Assuming that the new mortgage instruments are unsubsidized as is the traditional FHA 203(b) program, then there would appear to be no reason to preclude the participation in this program to those who presently do not own a home.

In providing this experimental authority to HUD, this Association feels the Committee should instruct the Secretary to work on variations of the fixed-rate mortgage since that has been and presently is the safest and most acceptable mortgage instrument from the viewpoint of the consumer and particularly the marginal homebuyer.

We are concerned that the fixed-payment mortgage remain the mainstay of FHA mortgages, and we would be extremely concerned if the experimental authority prescribed in Title I were construed as a directive to HUD to abandon the fixed-rate mortgage.

The FHA Section 245, graduated payment mortgage program is a good example of a variation of a fixed-payment mortgage since the homebuyer knows exactly what to expect over the life of the mortgage. We are proud to have been among those who testified a few years ago of making permanent the FHA Section 245 graduated payment program. This program has proved to be ideally suited for young families whose current income is not high enough to qualify for a traditional fixed-payment mortgage. In addition to being a program which has aided homebuyers, however, the HUD graduated payment mortgage has not been a give-away which has threatened the financial viability of the FHA program. It is an unsubsidized program that has worked well.

Title II of S. 1702 authorizes the Secretary of HUD to insure mortgages that would mature within 5 years but that would be amortized over a longer period. Since the refinancing of the loan, as described in Section 201, is at the discretion of the Secretary of HUD, it is not clear whether or not the mortgages envisioned here will be balloon loans or renegotiable rate loans similar to the rollover mortgages that are popular in Canada.

We believe Title II could be improved greatly if the discretion of HUD Is removed as to the refinancing of a matured mortgage. Of course such refinancing would be contingent on proper underwriting in accordance with FHA standards and thus, would not increase the risk on the part of the government. A rollover mortgage would give borrowers reasonable economic security as they would be assured of level

payments for at least 5 years. Of all the adjustable-rate mortgages offered by the Federal National Mortgage Association, the most popular is Plan 6 which has interest payment adjustments every 5 years. This shows that a 5-year rollover could be very acceptable to the consumer with adequate protection for lenders.

Perhaps the Secretary should be given specific authority to insure both balloon and rollover mortgages. Balloon payment mortgages have become increasingly popular because they offer borrowers the advantage of obtaining a fixed-interest rate and payment amount for a specified period, along with the assurance that they will not be trapped with a long-term loan carrying a higher interest rate than is currently available in the market. Also, interest rate buydowns are cheaper due to the short maturity of the loan. There are, of course, risks associated with short-term lending—namely, at maturity of the loan, the borrower may be unable to afford to refinance the outstanding balance forcing the borrower to sell the property or to default. These risks tend to be diminished if the borrower's income is likely to increase along with his equity resulting from appreciation of the security property. However, 5-year balloon mortgages involve somewhat of a gamble that interest rates will fall or that mortgagors' income will rise. This is not the correct instrument for the truly marginal homebuyer.

The Federal Home Loan Bank Board (FHLBB) is attempting to change current regulations to permit federally chartered thrifts to offer non-amortized and partially amortized home loans to amounts up to 95 percent of the value of the property securing the loan. In addition, the proposal would delete the current five-year restriction on the life of this type of loan, thus allowing the length of such loans to extend up to 40 years.

By permitting a loan term of up to 40 years on balloon mortgages, borrowers and lenders will have much greater latitude in structuring the loan. This would be particularly useful for first-time, moderate income homebuyers who could more easily qualify for the lower monthly payment associated with a 15-year loan with payments amortized over 30 years. In addressing the questions of the balloon mortgage, the Subcommittee should consider extending the 5-year maturity, as did the Bank Board, to give greater flexibility to this program.

The Association applauds the Chairman's effort in Title II to authorize GNMA to guarantee securities that would provide access to secondary markets for mortgages authorized by Title II. Clearly, mortgage-backed securities are an essential element in today's mortgage finance industry and these GNMA securities could perhaps attract new sources of investors seeking morgage-backed securities with a shorter maturity.

A technical reading of S. 1702, however, indicates GNMA would be given the authority, under its Special Assistance Functions, to actually purchase the mortgages. Since this would require funds from the Treasury and would increase the federal deficit, placing upward pressure on interest rates, the Association could not support the actual purchase by GNMA of the mortgages. However, if the intent of S. 1702 is to enable GNMA to guarantee securities backed by these 5-year mortgages, no statutory language is necessary. Section 306(g) of the National Housing Act authrizes GNMA to guarantee securities backed by any FHA insured mortgage. Therefore, strong committee report language directing the rapid development of a 5-year GNMA mortgage-backed security may be appropriate.

Mr. Chairman, we generally support most of the other provisions of S. 1702. Clearly some work must be done to make FHA better able to operate in today's economy. The future of FHA may be uncertain, but any solution associated with that agency's operations will certainly point to a need for greater flexibility.

Congress recognized this need last year and authorized a trial program whereby the interest rate on 10 percent of FHA's unsubsidized mortgage activity or 50,000 loan approvals, whichever is larger, would be subject to negotiation between lenders and borrowers. The results of a negotiated FHA interest rate experiment yet to begin operation should provide direction to FHA's future use and need.

In closing we would like to reiterate our concern that the fixed-payment mortgage continue to be the mainstay of the FHA unsubsidized mortgage insurance program. None of the expanded activity outlined in S. 1702 should be construed to be a diminution of the FHA support of the fixed-payment mortgage.

Mr. Chairman, thank you for providing needed leadership on the determination of the future role of FHA mortgage insurance and we look forward to working with you on this matter.

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